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Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States

TSG WATER RESOURCES, INC., et al.,

Petitioners,

v.

D'ALBA & DONOVAN CERTIFIED PUBLIC ACCOUNTANTS, P.C.,

Respondent.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is the Eleventh Circuit's ruling applying the "nerve center" test to determine the Appellant's principal place of business appropriate since the application of this test is in conflict with the decisions of other circuits?

2. Did the Eleventh Circuit properly adopt and apply a new rule, in conflict with prior decisions of the Eleventh Circuit, the courts of Georgia and other federal circuit courts, that an auditor who has been found to have had the requisite scienter for securities fraud cannot be held liable to investors who reasonably relied on audited financial statements in making their investments, unless the investors relied solely on the audit opinion?

3. Did the Eleventh Circuit, interpreting Georgia law and without certifying the issue to the Supreme Court of Georgia, properly adopt and apply a new rule that, as a matter of public policy in Georgia, an auditor is not prohibited from including in its engagement letter a provision exculpating the auditor from liability?

PARTIES TO THE PROCEEDING

Petitioners are TSG Water Resources, Inc.; TSG Technologies, Inc.; Donald L. Mayer; Paul S. Steward; Jonathan D. Sprague; Robert M. Bolz; John A. Bolz; William Roger Holden; and OGM Family Limited Partnership. TSG Water Resources, Inc. and its wholly-owned subsidiary, TSG Technologies, Inc., are two corporations engaged in the business of designing and constructing wastewater facilities and desalinization plants primarily for municipalities, hotels and resorts in the southeastern United States and Caribbean. TSG Water Resources, Inc. retained Respondent to audit the year 2000 financial statement for it and TSG Technologies, Inc. Petitioners Donald Mayer, Jonathan Sprague and Paul Steward were directors of and investors in TSG Water Resources, Inc. Petitioners Robert Bolz, John Bolz, William Roger Holden, and OGM Family Limited Partnership were investors in TSG Water Resources, Inc. All of the Petitioners were plaintiffs in the District Court and Appellants in the Court of Appeals.

Respondent is D'Alba & Donovan Certified Public Accountants, P.C. Respondent was a defendant in the District Court and an Appellee in the Court of Appeals.

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PETITION FOR WRIT OF CERTIORARI

Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the Eleventh Circuit Court of Appeals (App. at A-1) is reported at 2007 U.S. App. LEXIS 29724 (11th Cir. Ga. Dec. 20, 2007). The only reported decision of the District Court (App. at A-45) appears at 366 F. Supp. 2d 1212 (S.D. Ga. 2004).

JURISDICTION

The judgment of the Court of Appeals was entered on December 20, 2007. Petitioners' motion for rehearing was denied on January 22, 2008. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This petition involves the issue of the conflict among the circuits regarding the proper test employed to determine the citizenship of a corporation pursuant to 28 U.S.C. § 1332, a complete copy of which is included within the Appendix attached hereto. This petition also involves the certification of questions concerning unsettled Georgia law to the state's highest court pursuant to O.C.G.A. § 15-2-9(a), which provides:

The Supreme Court of this state, by rule of court, may provide that when it shall appear to the Supreme Court of the United States, to any circuit court of appeals or district court of the United States, or to the Court of Appeals or the District Court of the District of Columbia that there are involved in any proceeding before it questions of the laws of this state which are determinative of the case and there are no clear controlling precedents in the decisions of the Supreme Court of this state, such federal court may certify the questions of the laws of this state to the Supreme Court of this state for answers to the questions of state law, which certificate the Supreme Court of this state may answer by written opinion.

STATEMENT OF THE CASE

Petitioner TSG Water Resources, Inc. ("TSG Water") is principally engaged in the business of designing and constructing wastewater facilities and desalination plants primarily for municipalities, hotels and resorts in the southeastern United States and Caribbean. Petitioner TSG Technologies, Inc. ("TSG Tech") is a wholly-owned subsidiary of TSG Water and is primarily involved in the engineering and fabrication of water treatment facilities for TSG Water.[1]

In 1998, TSG Water began a new business of designing, building and operating treatment plants. Petitioners Jonathan Sprague ("Sprague"), Donald Mayer ("Mayer"), and Paul Steward ("Steward") have, at all times relevant to this action, been officers and/or directors of TSG Water. Petitioners John Bolz, Robert Bolz, and Roger Holden ("Holden") have never been members of the company's management, but, along with Mayer, Sprague, Steward, and Petitioner OGM Family Limited Partnership ("OGM"), have invested varying amounts of money in TSG Water.

The fraud or, at the very least, gross negligence committed by Respondent against Petitioners in this case has its genesis with Morris Bencini[2], who joined

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[1] Throughout this brief, Petitioners TSG Water and TSG Tech may collectively be referred to as "TSG".

[2] Morris Bencini was originally a defendant in this case. The District Court's dismissal of Bencini was reversed by the Eleventh Circuit's December 20, 2007 Order.

TSG as its chief financial officer in 1999. While CFO of TSG, Bencini performed the duties typically associated with that office. Bencini's normal duties as CFO included preparing financial statements, arranging financing for and analyzing utility projects, and otherwise managing the financial affairs of the company on a daily basis.

Bencini was authorized, with the knowledge and approval of management, to engage Respondent D&D to perform the audits of the company's 1999 and 2000 financial statements. In April 2000, D&D issued its audit of the prior year's financial statements showing the company had a loss of $855,138.

Throughout calendar year 2000, Bencini provided quarterly and other periodic financial statements to management that each showed the company was earning a profit. In early 2001, Bencini prepared and presented to the board consolidated financial statements for TSG Water for the year 2000 which showed that the company had generated a profit of over $38,000. This was the first time the company had shown a year-end profit and was viewed by the company's management as an important milestone.

In November 2000, D&D was again engaged to perform an audit of the company's 2000 financial statements prepared by Bencini. None of the individual Petitioners had any substantive discussions with the D&D auditors concerning the company's finances while D&D performed its audit fieldwork. On or about April 27, 2001, D&D issued its audit report which represented that the company had earned

a profit of $68,926. For TSG Water's board and management, the fact that the company had shown a profit for the first time and had "turned the corner" financially was both promising and encouraging. The representations contained in the 2000 audited financial statements led Sprague, Mayer, the Bolzes, Holden, Steward, and OGM to invest substantial amounts of money in the company in the summer of 2001.

Unbeknownst to Petitioners, the audit report prepared by D&D overlooked numerous errors, many of them basic, that concealed the fact that the company had suffered a loss of over one million dollars for 2000. These included:

1. Failure to follow percentage of completion rule, resulting in the entire projected profit for a major project being included in a single year;

2. Booking of a deferred tax asset without adequate evidence that the company would likely be profitable in the near future, as required;

3. Improperly allowing capitalization of marketing costs;

4. Failing to account for the company's liability for 401(k) contributions;

5. Capitalizing costs for development of vessel prototypes despite the fact that the

prototypes underwent destructive testing and, thus, could not be added to inventory; and

6. Failing to account for a tax liability to the United States Virgin Islands.

By May 2001, Bencini discovered that TSG was experiencing a substantial cash flow problem and he then re-examined the accounting he had done for the prior year. Bencini and certain key personnel at D&D discussed the accounting errors associated with the Burnt Store project. Rather than notifying all of TSG's management and board of directors, Bencini only informed the company's president at the time, James Walker, of the problem.

On May 22, 2001, the directors and shareholders of TSG held their annual meetings. Bencini was present at both. During these meetings, Walker emphasized that the company had "turned the corner" after becoming profitable for the first time and that the prospects looked great. Despite knowing that a serious cash crunch was looming and that the 2000 audited financial statements were severely misstated, Bencini remained silent at both of these meetings.

By early June 2001, TSG Water's management learned that a large contractor for the Burnt Store project had not been paid. In reliance upon the profit shown by Bencini in his 2000 year-end financial statements as certified as materially correct by D&D and without knowledge that the company's true financial condition was completely different,

Petitioners Sprague, Mayer, the Bolzes, Holden, Steward, and OGM (the "Investor Petitioners") in June and July 2001 invested varying amounts of money in TSG Water. The amount of such investments totaled over $1.45 million.

On October 24, 2002, Petitioners initiated this action in the State Court of Chatham County, State of Georgia. Based upon alleged diversity of citizenship, Respondent and Bencini removed this action to the United States District Court for the Southern District of Georgia, Savannah Division, relying upon 28 U.S.C. § 1332.

After a period of discovery, Respondent filed a motion for summary judgment, to which Petitioners filed timely responses. On May 10, 2004, the District Court granted Respondent D&D's motion in part.

Trial began on January 30, 2006. At the conclusion of the case, the jury entered judgment in favor of Petitioner TSG Water in the total amount of $317,000, less 10% contributory negligence. Shortly thereafter, Respondent submitted a Motion for Judgment as a Matter of Law. On August 4, 2006, the District Court granted Respondent's renewed Motion for Judgment as a Matter of Law and nullified the jury's verdict, finding that the exculpatory language contained in the Engagement Letter was valid and barred Petitioner TSG's claims. Petitioners subsequently appealed this matter to the Eleventh Circuit.

After oral hearing, the Eleventh Circuit vacated and remanded the dismissal of Petitioners' claims with respect to Bencini. However, the court held that Petitioners' fraud and securities fraud claims against Respondent's were properly dismissed on the basis that Petitioners' reliance upon the year 2000 audit report was not justifiable as a matter of law. The Eleventh Circuit supported this finding by adopting a new rule based solely on dicta in a Georgia Court of Appeals case and refusing to otherwise apply the clear holding of that case.

The Eleventh Circuit also ruled that the exculpatory clause found in the engagement letter between Petitioner TSG and Respondent was valid and not contrary to public policy and thus barred Petitioners' claims. Finally, the Eleventh Circuit found that the District Court properly concluded that Petitioner TSG Technologies was a resident of the state of Georgia and thus federal diversity jurisdiction was present.

Petitioners petitioned for a rehearing on January 10, 2008, which was denied on January 22, 2008. This petition for writ of certiorari ensues.

REASONS FOR GRANTING THE WRIT

1. *The Eleventh Circuit's Application of the MacGinnitie Test in Determining Diversity Was Flawed and Inconsistent With the Tests Applied in Other Circuits*

In its opinion, the Eleventh Circuit applied its adoption of the "total activities" test as set forth in the case of *MacGinnitie v. Hobbs Group, LLC*, 420 F.3d 1234 (11th Cir. 2005). There is clearly a difference of opinion among the circuits on the proper test for determining corporate citizenship. *See e.g. J.A. Olson Co. v. City of Winona, Miss.*, 818 F.2d 401 (5th Cir. 1987) (discussing differences in citizenship analyses). "The courts of appeal now use three tests to determine a corporation's principal place of business: the 'nerve center' test, the 'corporate activities' test, and . . . the 'total activity' test." *Amoco Rocmount Co. v. Anschutz Corp.*, 7 F.3d 909, 914-15 (10th Cir. 1993) (quoting 13B CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3625, at 129 (2d. ed. Supp. 1993)). *See e.g., Wisconsin Knife Works v. National Metal Crafters*, 781 F.2d 1280, 1282 (7th Cir. 1986) ("[t]he test in this circuit for principal place of business is 'nerve center'); *Shell Rocky Mt. Prod., LLC v. Ultra Res., Inc.*, 415 F.3d 1158, 1162 (10th Cir. 2005) ("[T]his court [has] adopted the 'total activity' approach to the principal place of business determination); *Capitol Indem. Corp. v. Russellville Steel Co.*, 367 F.3d 831, 835 (8th Cir. 2004) (stating that although the "Eighth Circuit has not adopted a test for determining a corporation's 'principal place of business' . . . [d]istrict courts within the Eighth Circuit

have applied the most open-ended [test]-the 'total activity' test."); *CGB Occupational Therapy v. RHA Health Servs.*, 357 F.3d 375 (3d Cir. 2004) ("This Circuit employs the 'center of corporate activities' test to determine a corporation's principal place of business.")

As a result of these numerous tests, it is evident that similar fact patterns can produce different results in different circuits. In the present case, it is likely that Petitioner TSG Technologies would have been considered a resident of Florida using the test applied by the Fifth Circuit in *J.A. Olson Co.* In light of the different tests employed by the circuits and the inequity of disparate outcomes despite similar factual scenarios, Petitioners respectfully request that their petition be granted.

2. *The Eleventh Circuit Misapplied the White Decision Creating a Conflict with Other Circuits*

In affirming the dismissal of Petitioners' claims against Respondent, the Eleventh Circuit adopted a new rule that is unprecedented and is in conflict with the decisions of other federal circuits as well as Georgia law. The rule it adopted and applied is that an accountant who is proven to have engaged in securities fraud cannot be held liable to the defrauded investors unless the materially false audited financial statements were the sole or primary basis of the investors' decisions. In so doing, the Eleventh Circuit ignored essentially all of the established law on this issue under both Georgia law and federal law.

Before reaching its ruling on this issue, the Eleventh Circuit found, *inter alia*:

1. There was sufficient evidence that audited financial statements were materially false.

2. There was sufficient evidence of collusion between the company's CFO and the auditor.

3. There was sufficient evidence of proximate cause.

4. There was sufficient evidence that the investors justifiably relied on the audited financial statements.

5. There was sufficient evidence of scienter as to both the common law fraud and securities fraud claims.

With these key elements established, under both the well settled law in Georgia, including the *White, infra,* decision, as well as federal securities law, which is considered persuasive authority in Georgia cases, a ruling in favor of the investors and against D&D should have been entered. Instead, the Eleventh Circuit chose to adopt a new rule that effectively immunizes independent auditors even in cases of proven fraud.

The Eleventh Circuit fashioned its new rule based solely on a tortured reading of a single Georgia

Court of Appeals case, *White v. BDO Seidman, LLP*, 549 S.E.2nd 490 (Ga. Ct. App. 2001). The Eleventh Circuit did not, however, apply the actual holding in *White*, but instead adopted this new rule based solely on *dicta*.

The plaintiffs in *White* invested, through their brokerage firms, in publicly-traded GWAM securities. BDO Siedman ("BDO") issued audit opinions of GWAM's financial statements for several years which showed continuing losses. Most importantly, and directly contrary to the facts in the instant case, most of the investors in *White* did not review GWAM's financial statements or even see or hear of BDO's audit opinion prior to making their investments, and **none** of the investors in White asserted that they actually relied upon **any representations**[3] in BDO's audit opinion in making their investment decision. 249 Ga.App. at 670, 549 S.E.2d at 492. In this case, it is undisputed that all of the investors, both the inside director investors and the outside investors, either read or were specifically aware of the audited financial statements, and the profitability they certified, and relied on them in making their investment decisions.

Although the *White* investors did not read or rely on any misrepresentations in the BDO audited financial statements, they nonetheless brought claims against BDO for allegedly negligent audits. In order to satisfy the reliance element of a negligent

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[3] Indeed, there is no indication in *White* that there were any misrepresentations, actual or even alleged, in the financial statements or the BDO audit opinion.

misrepresentation claim, these investors argued that they were entitled to a presumption of reliance, similar to the "fraud on the market" or "fraud on the regulatory process" presumption of reliance seen in securities fraud cases. The investors further argued that they indirectly relied on BDO's "audit opinion" because the SEC would not have approved, nor would the brokers have sold, the securities without the BDO audit. It was therefore the *White* plaintiffs' position that the **mere fact** that an audit had been conducted and an audit opinion published was all that was necessary to satisfy the "justifiable reliance" requirement of a negligent misrepresentation claim.

It was in this context that the Georgia Court of Appeals, after specifically recognizing, as the Eleventh Circuit did, that **investment decisions are inherently based on a number of factors**, rejected a **presumption** of reliance on the financial statements, stating:

> Thus, an investment decision based **solely or primarily** on an accountant's audit report would be, in most cases, difficult to justify. Consequently, we see no reason why such an investor should be **presumed** to have relied upon it in a common law negligent misrepresentation case.

249 Ga. App. at 672, 549 S.E.2d at 494. (emphasis added) The *White* court then went on to hold:

> For these reasons, we **hold** that appellants must show that they actually

> and justifiably relied on the **representations in BDO's auditing reports** before they may recover for their investment losses under a common law negligent misrepresentation theory of recovery.

Id. (emphasis added). This is the actual holding of *White* which neither the District Court nor the Eleventh Circuit even mentioned.

While the actual holding in *White* clearly contemplates actionable negligent misrepresentation claims against accountants for misrepresentations in audit reports, the Eleventh Circuit adopted a rule based upon inapplicable *dicta* to reach the opposition conclusion—that Petitioners here cannot justifiably rely on representations in an audit report which are acknowledged to be misleading. This holding is not only contrary to *White*, but it is contrary to all of the cases which hold that an accountant can be subject to primary liability under Section 10(b) for false and misleading audit reports.

In holding that Petitioners could not justifiably rely on Respondent's audit report, the Eleventh Circuit appears to have taken the *dicta* in *White* that ". . . an investment decision based solely or primarily on an accountant's audit report, would be in most cases difficult to justify" and erroneously applied it totally out of context.[4] But a plain reading of *White* and the

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[4] This of course begs the question of whether one could partially rely on an audit. If so, Respondents here clearly qualify because

authorities cited therein, make it manifest that the use of the words "solely or primarily" was not intended to suggest an exclusive bank of investment data, but instead to mean "the mere fact" that an audit occurred. In other words, *White* can only mean that one cannot claim that the **mere existence** of an audited financial statement, standing alone, could be justifiably relied upon, without more. This is the only interpretation that makes sense in a "presumption of reliance" analysis. Nowhere does *White* suggest, as the Eleventh Circuit appears to have held, that this proposition would preclude one from claiming reliance on specific misrepresentations in an audit report, which were actually read and relied upon, as here.

The Eleventh Circuit's holding on this issue is inconsistent with other federal law on this subject. Numerous circuit courts have held that an auditor is subject to liability for securities fraud for misrepresentations in an audit opinion which certifies financial statements. *See, Overton v. Todman & Co., CPA's, P.C.,* 478 F.3d 479 (2nd Cir. 2007) (investor principally relied on audited financial on 10(b) claim against auditor; Second Circuit reverses order dismissing complaint against auditor); *In re: Suprema Specialties Inc. Securities Litigation,* 438 F.3d 256 (3rd Cir. 2006) (Third Circuit reverses dismissal of claims against auditor for alleged misrepresentations in audited financial statements); *Cooper v. Pickett,* 137 F.3d 616 (9th Cir. 1997) *superseded by statute on other grounds, see In re Vantive Corp. Secs. Litig.*, 283 F.3d

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of the various other facts and data which the Eleventh Circuit acknowledges that they justifiably relied upon.

1079, 1091 (9th Cir.2002) (Ninth Circuit reverses dismissal of complaint alleging that auditor knowingly certified false and misleading financial statements); *McGann v. Ernst & Young,* 102 F.3d 390 (9th Cir. 1996) *cert. denied* 520 U.S. 1181, 117 S.Ct. 1460 (1997) (Ninth Circuit holds that an accounting firm is subject to primary liability under § 10(b) when it prepares a fraudulent audit report that it knows its client will include in a Form 10-K. 102 F.3d at 392); *Anixter v. Home-State Production,* 77 F.3d 1215 (10th Cir. 1996) ("Clearly, accountants may make representations in their role as an auditor selling securities . . . Typical representations include certifications of financial statements and opinion letters." 77 F.3d at 1225. Auditor can be liable as primary violator of securities laws for false and misleading audit reports). *See also,* Lewis D. Lowenfals and Alan P. Bromberg, *Liabilities of Lawyers and Accountants Under Rule 10b-5,* 53 Bus. Law. 1157 (1998).

The Eleventh Circuit's application of this new rule is not only inconsistent with the holding in *White* itself is also inconsistent with other Georgia cases. In the later case of *Mindis Acquisition Corp. v. BDO Siedman LLP,* 253 Ga. App. 360, 559 S.E.2d 111 (2002), *rev'd on other grounds,* 276 Ga. 311, 578 S.E.2d 400 (2003), the Georgia Court of Appeals held that the reasonableness of an investor's reliance on an accounting firm's annual inventory audit opinion was a fact issue to be decided by a jury.

Petitioners are not aware of any case that holds that reliance on the audit opinion which certifies financial statements, standing alone, would be

unjustifiable. None of the cases cited above announce or even intimate such a principle. The one case that specifically points out the investor principally relied on the audit opinion reverses the dismissal of the investor claim against the auditor, thus suggesting that reliance on the audit alone could be reasonable. *Overton,* 478 F. 3d 479.

Nowhere in the many cases involving claims of misrepresentation in audited financial statements, is one to find an artificial barrier to recovery such as the one erected by the Eleventh Circuit. If anything, the certifying accountant should be held to a higher standard of conduct, and the investor who actually reads and relies on the audit, as here, should have less of a reliance burden, not more, with respect to the professional. As noted by the United States Supreme Court:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to investing public.

United States v. Arthur Young & Co., 465 U.S. 805, 817-818, 104 S.Ct. 1495, 1503 (1984) (italics in original).

In conclusion, the Eleventh Circuit has adopted a new rule that **fundamentally** and **incorrectly** changes the law of accountant liability for misrepresentations in audited financial statements and audit reports. This change is both contrary to Georgia law and in conflict with the law of other federal circuits. Furthermore, the Eleventh Circuit should have referred this matter to the Georgia Supreme Court. "Substantial doubt about a question of state law upon which a particular case turns should be resolved by certifying the question to the state supreme court." *Jones v. Dillard's, Inc.*, 331 F.3d 1259, 1268 (11th Cir. 2003). Georgia law permits the Eleventh Circuit to certify to the state supreme court "questions of the laws of this state which are determinative of the case and [concerning which] there are no clear controlling precedents in the decisions of the Supreme Court of this state . . ." O.C.G.A. § 15-2-9(a). Due to the Eleventh Circuits radical departure from the holding in *White* and the decisions of other circuits, the Eleventh Circuit should have certified this question to the Georgia Supreme Court for further clarification. Petitioners respectfully request that this Petition for Writ of Certiorari be granted and that the Summary Judgment in favor of Respondent on Petitioners' misrepresentation, fraud and securities fraud claims be vacated and remanded.

3. *The Eleventh Circuit's Misapplication of Georgia Law Allowing Accountants and Auditors to Avoid Liability for Negligent and Reckless Conduct Creates Wide-Ranging Public Policy Concerns and This Issue Should Have Been Referred to the Georgia Supreme Court*

The Eleventh Circuit held that the exculpatory clause in the engagement letter between Petitioner TSG and Respondent was enforceable and did not violate Georgia's public policy. In reaching this conclusion, the court noted that there is no state statute specifying a duty of care for accountants, as with certain professions, such as doctors and lawyers. However, there are other professions, like dentists, as to whom the courts in Georgia have also determined that public policy prohibits exculpatory clauses in the absence of a statute. It is clear that the use of exculpatory clauses by licensed professionals creates issues of public policy, as evidenced by case law in Georgia. Whether accountants should be entitled to use such clauses in their contracts with clients is a case of first impression in Georgia. Petitioners submit that it was inappropriate for the Eleventh Circuit to adopt a rule allowing the use of such clauses in Georgia that was both inconsistent with existing case law and against the substantial weight of authority nationally, without certifying the issue to the Georgia Supreme Court as permitted by O.C.G.A. § 15-2-9(a).

The Supreme Court of Georgia has determined, in the absence of a statute, that "it is against the public policy of this state to allow one who procures a

license to practice dentistry to relieve himself by contract of the duty to exercise reasonable care." *Emory Univ. v. Porubiansky*, 248 Ga. 391, 394 (1981). The Court in *Emory* notes the obligation imposed by law on professionals to use a "reasonable degree of care, skill, and ability such as is ordinarily exercised under similar conditions and like circumstances by persons employed in the same or similar professions." *Id.* at 394. Critically, this is a duty "apart from any express contractual obligation" and flows from the professional relationship itself as opposed to the express terms of the contract. *Id.* at 394. In this sense, a licensed medical professional is no different than a licensed accountant: both are required to utilize that level of skill ordinarily employed by their professions, and in both circumstances, the failure to do so can have far reaching implications for those who rely on their services.

Close examination of the Supreme Court's decision in *Emory* (hereinafter referred to as "*Emory II*"), as well as the underlying decision of the Georgia Court of Appeals in *Porubiansky v. Emory University*, 156 Ga. App. 602 (1980) (hereinafter referred to as "*Emory I*") is warranted. In *Emory I*, the Court of Appeals utilized the six-part test identified in *Tunkl v. Regents of University of California*, 60 Cal. 2d 92, 383 P.2d. 441 (1963) to reach its decision that exculpatory clauses in dental contracts were unenforceable. The factors applied in *Tunkl* are applicable to the accountant/client relationship and support a conclusion that public policy requires a similar prohibition.

Similarly, Georgia law regulates the practice of law and restricts an attorney's ability to limit his liability to a client. For example, rules of the State Bar of Georgia generally prohibit such an agreement:

> A lawyer **shall not** make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement.

Ga. R. & Regs. St. Bar 4-102(d), 1.8. Because the public policy of Georgia precludes professionals such as dentists and lawyers from exculpating their negligence, it logically follows that the same rule would apply to accountants.

The first factor discussed in *Tunkl* was whether the contract concerned a business "of a type generally thought suitable for public regulation." *Emory I*, 156 Ga. App. at 607. As evidenced by the fact that the State of Georgia established the State Board of Accountancy, and expressly granted it the authority to promulgate "Rules of professional conduct" for establishing and maintaining high standards of competence and integrity in the practice of public accountancy," O.C.G.A. § 43-3-5(a)(2), the State of Georgia has a direct and express interest in the profession of accountancy.

Regulations promulgated by the State Board of Accountancy further echo the state's interest in this profession. Pursuant to directive of the Georgia

Legislature, the State Board promulgates a Code of Professional Conduct for accountants. *See* O.C.G.A. § 43-3-5(a)(2). The purpose of this code of conduct is to "establish[] and maintain[] high standards of competence and integrity in the profession of public accountancy." Ga. Comp. R. & Regs. r. 20-12-.01. There can be no doubt that the State of Georgia has declared an important state interest in the accounting profession.

The last three *Tunkl* factors discussed in *Emory I* concern the relative bargaining position of the parties. In this consideration, the superior bargaining position of the professional flows from his experience and training, not the respective financial positions of the parties. *Emory I*, 156 Ga. App. at 609. The same inequalities are present in the context of the accountant/client relationship: by virtue of its experience in accounting, the accounting firm has more knowledge about the accounting methods and procedures than does the client. It is this expertise that creates the unequal bargaining power.

The Eleventh Circuit opinion suggests that accounting services are not a practical necessity. That conclusion is inappropriate in this case because of the evidence that the Petitioner TSG Water was required to have annual audits of its financial statements by its banks. As a result, they could only gain access to necessary financing by providing these annual audits, which is the reason D&D was hired. Further, the Eleventh Circuit determined that the parties in this case were of equal bargaining power, yet the Eleventh Circuit did not acknowledge that fact *Tunkl*, as

discussed in *Emory I*, compels the rejection of such a conclusion because it is the expertise of the professional, not the parties' relative financial status, that creates the unequal bargaining positions. Finally, the Eleventh Circuit did not even mention the pronouncements of various regulatory agencies, including the Federal Reserve Board, Department of the Treasury, Office of Thrift Supervision, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation or the Securities and Exchange Commission which have opined that such engagement letters are impermissible and affect auditor independence. All of these authorities compel the conclusion that the exculpatory clause in D&D's engagement letter is violative of public policy and should not be enforced.

Alternatively, since the issue whether an accountant may contractually limit his liability has never been precisely addressed by Georgia courts, the Eleventh Circuit should have referred this matter to the Georgia Supreme Court. "Substantial doubt about a question of state law upon which a particular case turns should be resolved by certifying the question to the state supreme court." *Jones v. Dillard's, Inc.*, 331 F.3d 1259, 1268 (11th Cir. 2003). Georgia law permits the Eleventh Circuit to certify to the state supreme court "questions of the laws of this state which are determinative of the case and [concerning which] there are no clear controlling precedents in the decisions of the Supreme Court of this state . . ." O.C.G.A. § 15-2-9(a). In light of the fact that the validity of the exculpatory clause in the present case is determinative of several of Petitioners' claims in this case and was

used to strip Petitioners' of a jury verdict in their favor, the Eleventh Circuit should have certified this question to the Georgia Supreme Court for further clarification.

CONCLUSION

For the foregoing reasons, Petitioners TSG Water Resources, Inc.; TSG Technologies, Inc.; Donald L. Mayer; Paul S. Steward; Jonathan D. Sprague; Robert M. Bolz; John A. Bolz; William Roger Holden; and OGM Family Limited Partnership respectfully request the Court to grant their petition for writ of certiorari.

Respectfully submitted this 21st day of April, 2008.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 06-11803-HH

[DATE STAMP]
FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
JAN 22 2008
THOMAS K. KAHN
CLERK

TSG WATER RESOURCES, INC. (TSG),
TSG TECHNOLOGIES, INC.,
DONALD L. MAYER,
PAUL S. STEWARD,
JONATHAN D. SPRAGUE,
ROBERT M. BOLZ,
JOHN A. BOLZ,
WILLIAM ROGER HOLDEN,
OGM FAMILY LIMITED PARTNERSHIP,

Plaintiffs-
Counter-Defendants
Appellants,

versus

D'ALBA & DONOVAN CERTIFIED
PUBLIC ACCOUNTANTS, P.C,

Defendant-
Counter-Claimant Appellee,

MORRIS BENCINI,

Defendant-Appellee

On Appeal from the United States District Court
for the Southern District of Georgia

BEFORE: CARNES and BARKETT, Circuit Judges, and COHN,* District Judge

PER CURIAM

The petition for rehearing filed by the Appellant's is DENIED

ENTERED FOR THE COURT:

/s/ Ed Carnes
UNITED STATES CIRCUIT JUDGE

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*The Honorable James I Cohn, United States District Judge for the Southern District of Florida, sitting by designation.

[DO NOT PUBLISH]

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

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FILED
U.S. COURT OF APPEALS
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DECEMBER 20, 2007
THOMAS K. KAHN
CLERK

No. 06-11803

D.C. Docket No. 02-00258-CV-4

TSG WATER RESOURCES, INC. (TSG),
TSG TECHNOLOGIES, INC., et al.,

Plaintiffs-
Counter-Defendants Appellants,

versus

D'ALBA & DONOVAN CERTIFIED
PUBLIC ACCOUNTANTS, P.C.

Defendant-
Counter-Claimant Appellee,

MORRIS BENCINI,

Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Georgia

(December 20, 2007)

Before CARNES and BARKETT, Circuit Judges, and COHN,* District Judge.

PER CURIAM:

This appeal was brought following entry of final judgment against Plaintiffs TSG Water Resources, Inc., et al. After considering the issues on appeal, we reverse in part, affirm in part, and remand the case for further proceedings.

I. Background

TSG Tech, a wholly owned subsidiary of TSG Water, is a company that builds and sometimes operates water treatment facilities. The issues in this case relate to the preparation and auditing of TSG Tech's financial statements for the year 2000 and subsequent actions taken by its board members and other investors allegedly in reliance on those statements.

As of the year 2000, TSG Tech was being run by president James Walker, who is not a party to this action, and a small number of officers. Appellee Morris Bencini was hired as the Chief Financial Officer of the

*The Honorable James I. Cohn, United States District Judge for the Southern District of Florida, sitting by designation.

company in 1999, and was responsible for preparing monthly and quarterly financial statements for the company's management, board of directors, and investors, including the financial statements for the year 2000, as well as attending meetings of the board of directors and answering questions about financial matters. Bencini was also responsible for any attempts to acquire or merge with other companies, including arranging financing for these acquisitions or mergers. Appellee D'Alba & Donovan Certified Public Accountants, P.C. ("D&D") was hired to conduct an audit of the year 2000 financial statements.

Due to a number of accounting errors, discussed in greater detail below, the financial statements for the year 2000 significantly overstated the financial health of the company and incorrectly indicated that it had turned a profit for the first time in its history. The company's cash flow situation reached a crisis point in June 2001, and the board of directors was forced to decide whether to let the company fail or to invest more capital. Believing the cash flow problems to be short-term in nature, allegedly because of the positive outcome in the previous year represented in the financial statements, several members of the board of directors invested money themselves, and solicited outside investments from friends and family members totaling over $1.45 million. When the accounting errors were later discovered, and the true financial state of the company revealed, the board of directors took steps to dilute Walker's majority interest and remove him as president.

II. Procedural History

The case was originally filed in federal court, but was voluntarily dismissed and re-filed in state court. The Complaint alleged claims of breach of fiduciary duty, fraud, securities fraud, and breach of contract against both D&D and Bencini. In addition, the Complaint alleged claims of professional negligence, ordinary/gross negligence, and negligent retention and supervision against D&D. Defendants D&D and Bencini removed the case to the United States District Court for the Southern District of Georgia, asserting diversity jurisdiction. The District Court denied Appellants' Motion to Remand, finding that TSG Tech was a resident of Georgia for purposes of diversity jurisdiction.

Appellees each filed separate Motions for Summary Judgment. The District Court issued an Order before the trial granting Bencini's Motion in its entirety and D&D's Motion in part, leaving only the claims against D&D of professional negligence, ordinary and/or gross negligence, and breach of contract for trial. Following the trial, the jury reached a verdict in favor of TSG in the total amount of $317,000, less 10% for contributory negligence. However, upon a renewed Motion for Judgment as a Matter of Law, the District Court found that the exculpatory language contained in the engagement letter was valid and barred TSG's remaining claims, and the Court entered final judgment in favor of D&D. Appellants then filed the instant appeal.

III. Jurisdiction of the District Court

On appeal to this Court, Appellants first contend that the District Court lacked jurisdiction over the case and should not have denied their Motion to Remand. The District Court found that Georgia was TSG Tech's principal place of business and state of incorporation, and denied the Motion to Remand. Appellants contend on appeal that TSG Tech's principal place of business is Florida. Thus, Appellants argue, because Bencini is also a resident of Florida, there was no complete diversity, and the District Court erred in denying the Motion to Remand.

We review rulings on the subject-matter jurisdiction of the District Court *de novo*. *MacGinnitie v. Hobbs Group*, 420 F.3d 1234, 1239 (11th Cir. 2005); *Williams v. Best Buy Co.*, 269 F.3d 1316, 1317 (11th Cir. 2001). A clearly erroneous standard of review is not applied to findings of fact that are premised upon an erroneous view of controlling legal principles. *Johnson v. Uncle Ben's*, 628 F.2d 419, 422 (5th Cir. 1980). The District Court's factual findings regarding a company's principal place of business, however, are subject to a clearly erroneous standard of review. *Id.; Vill. Fair Shopping Ctr Co. v. Sam Broadhead Trust*, 588 F.2d 431, 434 (5th Cir. 1979). We examine the subject matter jurisdiction of the trial court as a threshold matter before considering the merits of the appeal. *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 94 (1998).

Complete diversity requires that no defendant in a diversity action be a citizen of the same state as

any plaintiff. 28 U.S.C. § 1332; *Carden v. Arkoma Assocs.*, 494 U.S. 185, 187 (1990). For purposes of diversity jurisdiction, a corporation is a citizen of both the state in which it is incorporated and the state in which it has its principal place of business. 28 U.S.C. § 1332(c). The legal standard used in this Circuit to determine a company's principal place of business for purposes of diversity jurisdiction is the "total activities" test. *MacGinnitie*, 420 F.3d at 1239; *Toms v. Country Quality Meats, Inc.*, 610 F.2d 313, 315 (5th Cir. 1980). The "total activities test" is a combination of the "place of activities" test and the "nerve center" test used in other circuits. *MacGinnitie*, 420 F.3d at 1239. Under the "place of activities" test, the location where most of the company's sales or production takes place is typically determined to be its principal place of business. *Id.* Under the "nerve center" test, the location of the company's corporate offices is usually determined to be its principal place of business. *Id.* When the results of these two tests differ, under the "total activities" test, the district court must conduct a "somewhat subjective analysis" to choose between the two results. *Id.* Eleventh Circuit cases have held that where a company's activities are not concentrated in one place, a district court may place greater emphasis on the "nerve center" test when determining principal place of business. *MacGinnitie*, 420 F.3d at 1239 (*interpreting Sweet Pea Marine, Ltd. v. APJ Marine, Inc.*, 411 F.3d 1242, 1248 (11th Cir. 2005)).

Appellants argue that the District Court placed inappropriate weight on the "nerve center" factors because the physical activities of the company were concentrated in Florida, not diffused throughout the

Caribbean as the District Court concluded. Upon review of the District Court's Order, it appears that the Court considered all the facts and made adequate findings to support its ruling. In reciting the facts of the case, the Court stated that "on any given project, TSG Tech does all of its design and engineering, much of its purchasing and most of its fabrication in Gainesville [Florida]." (Order Denying Remand, p. 5.) However, the Court also noted that "many of the water and waste water treatment plants that TSG Tech operates are in the Caribbean" and "in 2002, most of TSG Tech's revenue came from work in the Caribbean." (*Id.* at 3.) Ultimately, the Court found that "while TSG Tech comes into contact with the public in Florida, many of the daily activities of TSG Tech occur in Florida, and TSG Tech maintains its tangible assets in Florida, the activity which occurs in Georgia is more significant." (*Id.* at 7.) Thus, the District Court clearly articulated its finding that many of TSG Tech's activities, though not a majority of them, were carried on in Florida. In light of the holding in *MacGinnitie*, this finding by the District Court is adequate to support the conclusion that the "nerve center" factors should have greater weight in the determination of the principal place of business.

Furthermore, the record before the District Court contained substantial evidence of TSG's activities in Georgia that supports the Court's ruling. TSG Tech's corporate records, banking records, accounting records, and original contracts are maintained at the Savannah, Georgia headquarters of its parent company, TSG Water. TSG Water directs the activities of TSG Tech and other subsidiaries from

the Georgia headquarters. The decision-makers for TSG Tech, including its directors and two of its officers, are also located in Georgia. Only one of the four officers is located in Florida, and the TSG Tech board of directors has never met in Florida. The payroll, insurance, and accounts payable for TSG Tech are controlled and directed by the Georgia office, which also prepares financial statements and invoices. The accounting and legal professionals used by TSG Tech are also located in Georgia. Additionally, TSG Tech's primary operating bank account is located in Georgia, and all the signatories to the account are persons located in Georgia. On this record, and with greater emphasis properly placed on the "nerve center" factors pursuant to *MacGinnitie*, the District Court's finding that TSG Tech's principal place of business was in Georgia is not clearly erroneous. Thus, the District Court's denial of the Motion to Remand is affirmed.

IV. Summary Judgment

Appellants also appeal the District Court's grant of summary judgment in favor of Appellee Bencini on the breach of fiduciary duty claim and in favor of Appellees Bencini and D&D on the fraud, securities fraud, and negligence claims. We review *de novo* the District Court's grant of summary judgment, and apply the same legal standard as the District Court. *Watkins v. Ford Motor Co.*, 190 F.3d 1213, 1216 (11th Cir. 1999). The District Court may grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party

is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

The District Court granted summary judgment in favor of Appellee Bencini on the breach of fiduciary duty claim, basing its ruling on the business judgment rule, and granted summary judgment in favor of Appellees Bencini and D&D on the fraud, securities fraud, and negligence claims.

A. Business Judgment Rule and the Breach of Fiduciary Duty Claim

In granting summary judgment in favor of Bencini on the breach of fiduciary duty claim, the District Court concluded that Bencini was protected by the business judgment rule. Appellants contend, on appeal, that a genuine issue of material fact exists as to whether Bencini acted fraudulently, in bad faith, or in an abuse of his discretion. "The business judgment rule protects directors and officers from liability when they make good faith business decisions in an informed and deliberate manner." *In re Munford, Inc.*, 98 F.3d 604, 611 (11th Cir. 1996). The presumption is that they have acted "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Cottle v. Storer Commc'n, Inc.*, 849 F.2d 570, 575 (11th Cir. 1988). Unless this presumption is rebutted, they cannot be held personally liable for managerial decisions. *Stepak ex rel. Southern Co. v. Addison*, 20 F.3d 398, 403 (11th Cir. 1994). However, officers may be held liable where they engage in fraud, bad faith, or an abuse of discretion. *Cottle*, 849 F.2d at 574. To survive a motion

for summary judgment, a plaintiff "must allege specific facts that show a genuine issue of material fact concerning fraud, bad faith or abuse of discretion." *Id.* at 575.

The core of Plaintiffs' claims against Bencini are the accounting errors he made in preparing the financial statements and his failure to advise the board of directors about those errors. Throughout the year 2000, Bencini provided financial statements to management that showed the company was earning a profit. The consolidated financial statements for the entire year 2000 showed a profit of over $38,000, making it the first year in which the company had ever shown a year-end profit. Bencini engaged Appellee D&D to conduct an audit of these year-end financial statements, and on April 27, 2001, D&D issued its report that the company had earned an even greater profit of $68,926. Based on this information, the board and management concluded that TSG Tech had "turned a corner" financially.

Subsequent review, however, revealed that a number of accounting errors contained in the year-end reports resulted in a major over-statement of the company's financial well-being. These included:

1. Failure to follow percentage of completion rule, resulting in the entire projected profit for the Burnt Store project being included in a single year;

2. Booking of a deferred tax asset without adequate evidence that the company

would likely be profitable in the near future, as required;

3. Improperly allowing capitalization of marketing costs;

4. Failing to account for the company's liability for 401(k) contributions;

5. Capitalizing costs for development of vessel prototypes despite the fact that the prototypes underwent destructive testing and, thus, could not be added to inventory;

6. Failing to account for a tax liability to the United States Virgin Islands.

By May 2001, Bencini discovered that TSG was experiencing a cash flow problem, and reexamined the accounting for the previous year. He discussed the accounting errors with personnel at D&D, and informed TSG Tech's president, James Walker, of the impending cash flow problem, but did not warn the board of directors or any investors. The annual meeting of directors and shareholders was held on May 22, 2001, at which Walker told the attendees that the company had "turned the comer" financially after becoming profitable for the first time in 2000. Bencini remained silent at this meeting.

In early June 2001, the threat of a lien on the Burnt Store project forced the directors to make prompt decisions regarding whether to invest

additional capital. The board of directors convened a meeting at which Bencini was not present. At this meeting, Walker provided explanations for the cash shortfall, and presented the directors with a cash flow spreadsheet that Bencini had prepared showing that the company could break even that year if it obtained certain projects and the proposed investments were made. The spreadsheets also showed monthly overhead expenses totaling $250,000, which Appellants allege is actually understated by approximately $80,000 per month. Several of the board members and other investors invested varying amounts of money totaling over $1.45 million in June and July 2001.

The District Court concluded that the business judgment rule protected Bencini's discretionary decisions regarding the accounting treatment applied to accurate core financial data in the year 2000 statements. The Court noted that no allegations of self-dealing on the part of Bencini had been made, and concluded that Bencini had discharged his duty to act in an informed and deliberate manner, as required by the business judgment rule, by relying on outside accounting experts. However, consulting with outside experts alone is not enough to satisfy the requirements of the business judgment rule. The cases cited by the District Court, and by Appellees in their briefs, stand only for the proposition that such consultation weighs in favor of a finding that the officer did not act in bad faith or abuse his discretion. In *Munford*, the court stated that "in this case, the record is replete with evidence that the directors and officers consulted legal and financial experts throughout the solicitation and

negotiation for a purchaser for Munford, Inc.," and concludes that applying the business judgment rule, the directors satisfied their duties. *Munford*, 98 F.3d at 611. The *Munford* court considered the totality of the facts in the case, not just the fact that the directors consulted with outside professionals, and the holding of the case is not based solely on the consultation. Similarly, in *Cottle*, the court reasoned that "the fact that the board did consult [an outside financial advisor] simply weighs in favor of finding that the directors did not abuse their discretion." 849 F.2d at 578. The simple fact that Bencini consulted with D&D is, therefore, not determinative.

Furthermore, the allegations and evidence in this case do create a disputed issue of material fact as to whether Bencini acted fraudulently, in bad faith, or in an abuse of his discretion. Contrary to the District Court's statement that no allegations of self-dealing had been made, Appellants have presented evidence that could indicate collusion between Bencini and D&D, including Bencini's prior relationships with individual accountants at D&D. Appellants have also presented evidence indicating that Bencini had much to gain from misrepresenting the financial health of the company. Even if Bencini did not act in bad faith, a genuine issue of material fact exists as to whether he abused his discretion in applying the incorrect accounting treatment and then not informing the board of directors of the error. The record shows that Bencini was aware of the inaccuracies sometime in May 2001, but he remained silent at a board meeting on May 22, 2001. Although he left the company on short notice soon after this meeting, Bencini also

prepared cash flow spreadsheets that were used specifically for the purpose of facilitating the board's decision regarding the company's cash flow crisis, and these spreadsheets allegedly understated overhead costs by approximately $80,000 per month. These facts, at a minimum, demonstrate a genuine issue of material fact as to whether Bencini acted in bad faith or abused his discretion and are sufficient to defeat a motion for summary judgment. Therefore, the District Court's grant of summary judgment to Appellee Bencini on the breach of fiduciary duty claim is reversed.

B. Fraud and Securities Fraud Claims

The District Court also granted summary judgment in favor of both Bencini and D&D on the fraud and securities fraud claims, concluding that there was inadequate evidence in the record to support findings of proximate cause, justifiable reliance, or intent. Appellants appeal this Order, arguing that the record contained genuine issues of material fact regarding these issues.

The tort of fraud has five elements: (1) false representation by a defendant; (2) scienter; (3) intention to induce the plaintiff to act or refrain from acting in reliance upon the representation; (4) justifiable reliance by the plaintiff upon the representation; and (5) damage to the plaintiff directly and proximately caused by the reliance. *Middleton v. Troy Young Realty, Inc.*, 572 S.E.2d 334, 336 (Ga. Ct. App.2002).

Securities fraud under Georgia law also has five elements: (1) a misstatement or omission, (2) of a material fact, (3) made with scienter, (4) on which the plaintiff relied, (5) that proximately caused his injury. *GCA Strategic Inv. Fund v. Joseph Charles & Assocs.*, 537 S.E.2d 677, 682 (Ga. Ct. App. 2000). "Misrepresentations are not actionable unless the complaining party was justified in relying thereon in the exercise of common prudence and diligence." *Id.*

1. Proximate Cause

Proximate cause is ordinarily a factual determination to be made by the jury, but "plain and indisputable cases may be decided by the court as a matter of law." *Thomas v. Food Lion, LLC,* 570 S.E.2d 18, 21 (Ga. Ct. App. 2002). In determining whether or not summary judgment is appropriate, courts must consider "whether the causal connection between the defendant's conduct and the injury is too remote for the law to countenance a recovery." *Id.* The District Court in this case concluded that "this is one of those plain and indisputable cases" where no reasonable jury could find proximate cause. The Court's analysis focused on the company's major financial problems, which were known to the plaintiff investors before they chose to make major "last ditch effort" loans to save the company. The Court reasoned that the cause of the investors' injuries was the combination of the company's extremely high expenses, lack of major income generation, and poor management by Walker, not any misrepresentations made by Bencini.

Although Walker's poor management and the company's high operating expenses certainly caused the company to reach a crisis point in June 2001, it is the subsequent decisions of the board members and investors, in reliance on Bencini's representations, and the following consequences that form the basis of the Complaint in this action. Appellants do not argue that the company would not have faced a financial crisis absent the alleged misrepresentations, they argue that the crisis would have been addressed differently and more effectively had they been given accurate financial statements. The record contains testimony from TSG's directors that had they known the 2000 financial statements were incorrect, they would have done in the summer of 2001 what they actually did do later in the year when they discovered the errors: take control from Walker, fire him, and cut payroll and expenses to save the company money. Furthermore, the year-end profit shown in the erroneous accounting statements for the year 2000 provided strong evidence to the board that the basic business model of the company was a good one, and that any financial problems were temporary in nature. The individual investors testified that their decisions to invest further in the company would have been very different had they known that the financial statements were inaccurate and that the business model was not, in fact, working.

The District Court characterized the board members' testimony as a mere "belief" that Walker would have lost control of the company earlier than he did, and stressed that evidence showing that an affiant "believes" something to be true is insufficient to defeat summary judgment. *See Pace v. Capobianco*, 283 F.3d

1275, 1278-79 (11th Cir. 2002). However, in light of the evidence that the board did, in fact, remove Walker later in 2001, once the errors were discovered, it is difficult to see how this testimony can be considered to be a mere "belief." Given this evidence in the record, we cannot agree with the District Court that it is "plain and indisputable" that proximate causation could not have been established.

2. Justifiable Reliance

Claims for both fraud and securities fraud require a finding of justifiable reliance under Georgia law. To show justifiable reliance on the misrepresented information in support of a securities fraud claim, a plaintiff "must show that 'with the exercise of reasonable diligence [it] still could not have discovered the truth behind the fraudulent omission or misrepresentation.'" *GCA Strategic Inv. Fund*, 537 S.E.2d at 464. To show justifiable reliance to support a common law fraud claim, a plaintiff must "prove that it exercised due care to discover the fraud." *Id.* The fundamental principle on this issue is that "misrepresentations are not actionable unless the complaining party was justified in relying thereon in the exercise of common prudence and diligence." *Id.* "While questions of due diligence often must be resolved by the trier of fact, that is not always the case. One may fail to exercise due diligence as a matter of law." *Fowler v. Overby*, 478 S.E.2d 919, 921 (Ga. Ct. App. 1996).

The District Court concluded that the investor plaintiffs, both those from within the company's board

of directors and the outside investors,[1] could not show justifiable reliance as a matter of law. In reaching this conclusion, the Court considered a Georgia Court of Appeals case that explained that "an investment decision based solely or primarily on an accountant's audit report would be, in most cases, difficult to justify." *White v. BDO Seidman, LLP*, 549 S.E.2d 490, 494 (Ga. Ct. App. 2001). The Court considered the evidence that the inside investors were present at the June 2001 meeting and knew the dire financial situation of the company. The Court concluded that, at a minimum, the negative information about the company's financial health should have put the inside investors on notice that they should "further explore the financial health of TSG before making any more investments in the company." (Order Granting Summary Judgment, p. 18.)

Based on *White*, we agree with the District Court that the investors cannot maintain the fraud claims against D&D because they were not justified in relying solely on D&D's audit report. However, we cannot reach the same conclusion with respect to the claims against Bencini. Unlike the situation presented in *White*, these investors did not rely solely on the financial statements in deciding to make their investments. These investors testified that they

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[1]We, like the District Court, differentiate between "inside" and "outside" investors. The "inside" investors are Directors of the company who also invested - Donald Mayer, Paul Steward, and Jonathan Sprague. The "outside" investors are friends and family members of Mayer who invested but were not otherwise involved with the company - Robert Bolz, John Bolz, William Holden, and OGM Family Limited Partnership.

considered all the financial information presented to them, and relied on the financial statements for the purpose of evaluating whether the company was fundamentally "broken" or the cash crisis was merely a short-term problem that could and should be remedied with further investments. To that end, they looked to the 2000 financial statements and relied upon them to the extent that they established that the company had shown a profit in the recent past. Their reliance on the financial statements as an accurate representation of the financial health of the company in 2000 was even more justifiable in light of the representations made by Walker at the May 2001 board meeting that the company had "turned the comer," to which Bencini did not object. In sum, the inside investors testified that they relied on the 2000 financial statements to gauge the severity of the crisis that arose in the summer of 2001 and to make decisions about how to address that crisis. In a footnote, the Court noted that it "finds unpersuasive Plaintiffs' attempts to characterize TSG's June 2001 severe cash flow problem as a short-term cash shortfall." (Order, p. 17.) This statement, however, appears to be a simple factual determination that the Court may not make at the summary judgment stage, where the facts must be construed in favor of the non-moving party. Given the evidence in the record, there appears to have been a genuine issue of material fact regarding justifiable reliance, and summary judgment on this basis was improper as to the claims against Bencini.

The outside investors, however, are in a distinctly different position from the inside investors

who actually reviewed and relied upon the financial statements. The District Court concluded that the outside investors did not reasonably rely on the 2000 financial statements. The evidence in the record is not disputed on this point, and shows that these outside investors did not rely on any financial statements, but rather relied on the representations of Mayer, one of the inside investors who was privy to the information as discussed above. This type of "indirect reliance" was clearly rejected in *White*, where the Georgia Court of Appeals held that Georgia law does not permit indirect reliance to substitute for proof of actual reliance. 549 S.E. at 493. Accordingly, we affirm the District Court's entry of summary judgment on the fraud claims as to the outside investors.

3. Intent

To prove a claim for fraud, a plaintiff must show intent to mislead. "A misrepresentation is intended to deceive where there is intent that the representation be acted upon by the other party." *Petzelt v. Tewes*, 581 S.E.2d 345, 347 (Ga. Ct. App. 2003). Proof of fraud is typically not susceptible of direct proof, and so circumstantial evidence must be used to establish fraudulent intent. *Id.* Thus, "it is peculiarly the province of the jury to pass on these circumstances showing fraud. Except in plain and indisputable cases, scienter in actions based on fraud is an issue of fact for jury determination." *Id.*

The District Court concluded that "there is no evidence to support the claim that Bencini and D&D knew that the Financial Statements would be used in

connection with an offer to sell securities in TSG or that the Investor Plaintiffs would be solicited for investment capital." (Order Granting Summary Judgment, p. 21.) Contrary to Appellants' arguments, a showing of recklessness under a theory of constructive fraud does not provide an alternate theory on which Appellants' common law fraud claim may be based. Constructive fraud is "not creative of any independent right of action for damages in tort in favor of the injured party; but [the misrepresentations] may support an action in equity to rescind a contract so induced." *Penn Mut. Life Ins. Co. v. Taggart*, 144 S.E. 400, 402 (Ga. Ct. App. 1928). Because Appellants seek to recover money damages in this action, this theory is inapplicable, and Appellants may not satisfy the intent element of their fraud claim with evidence of recklessness.

However, a showing of severe recklessness is adequate to support Appellants' claims for securities fraud. Although common law fraud in Georgia requires a showing that the misrepresentations were made with the intention and purpose of deceiving the plaintiff, securities fraud under Georgia law requires only that plaintiffs show that the representations were made with scienter. The United States Supreme Court has left open the question of whether scienter in the context of securities fraud can consist of not only intent, but also recklessness. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). The Eleventh Circuit, however, has concluded that a showing of "severe recklessness" can satisfy the scienter requirement in a securities fraud case. *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809,

814 (11th Cir. 1989).[2] Thus, the District Court's blanket finding that the record contained no evidence to show that D&D and Bencini actually intended to deceive the investors fails to differentiate between the two materially different state of mind standards in claims for fraud and claims for securities fraud. In addition to actual intent, severe recklessness would also be adequate to satisfy the scienter requirement in a claim for securities fraud. "'Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.'" *McDonald*, 863 F.2d at 814 (*quoting Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir. 1981)).

We must now consider whether adequate evidence existed in the record to create a genuine issue of material fact as to the intent requirement for Appellants' fraud claim and the scienter requirement for Appellants' securities fraud claim. Appellants argue that the sheer magnitude, number, and nature of the errors could give rise to a reasonable inference that Bencini intended to conceal the true financial condition of the company and mislead them. They also

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[2]Although *Ernst & Ernst* and *McDonald* both involve federal claims for securities fraud, they are instructive here. "[T]o evaluate a claim for securities fraud under [Georgia statutory law], we look to the similar elements a plaintiff must allege under section 10(b) of the Securities Act of 1934." *GCA Strategic Inv. Fund*, 537 S.E.2d at 682.

point to an email from Bencini to an accountant at D&D wherein he advises D&D that TSG was attempting to acquire other businesses and would need as much as $50 million to complete these desired acquisitions, of which $3 million to $10 million could be raised through the sale of stock. This email indicates that as of February 2000, when the email was sent, both Bencini and D&D were aware that significant efforts to obtain capital would be forthcoming, and this evidence could also support an inference that they intended to manipulate the accounting figures to appeal to potential investors. The record in this case also shows that capital had been raised from investments by the directors in the past, and so a jury could also infer from this that D&D and Bencini knew the directors could be called upon to invest again in the future. Although these pieces of evidence, taken individually, may not provide adequate evidentiary support on the element of intent, taken together they could support a reasonable inference by a jury that Bencini intended to mislead investors. At the very least, this evidence could support a finding that Bencini's errors and subsequent failure to correct the board members' impression of the company's financial health constituted severe recklessness. On this record, we conclude that adequate evidence existed to preclude summary judgment on the element of intent as to both the common law fraud and securities fraud claims.

V. Judgment as a Matter of Law Based on Exculpatory Clause

Appellants also argue that the District Court

erred in granting judgment as a matter of law in favor of D&D on the claims of professional negligence, ordinary and/or gross negligence, and breach of contract following the trial. The Court based its decision on the exculpatory language contained in D&D's engagement letter, concluding that this language barred the claims raised against D&D as a matter of law. The language on which the Court relied states that D&D is released from liability for any consequential, indirect, lost profit, or similar damages relating to D&D's services, except where those damages were the result of willful misconduct or fraud. (Order Granting D&D's Renewed Motion for Judgment as a Matter of Law, p. 2.) Because the Court had previously entered summary judgment in favor of D&D on the fraud claims, and the jury's verdict was based on negligence, the Court concluded that this clause barred recovery.

We review *de novo* the District Court's grant of judgment as a matter of law under Federal Rule of Civil Procedure 50, using the same standard as the District Court. *Cleveland v. Home Shopping Network*, 369 F.3d 1189, 1192 (11th Cir. 2004). Judgment as a matter of law is appropriate "where there is no legally sufficient evidentiary basis for a reasonable jury to find for that party on that issue." *Id.* We must review all the evidence in the record and draw all reasonable inferences in favor of the nonmoving party. *Id.* "Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge." *Id.* (*quoting Reeves v. Sanderson Plumbing Prods.*, 530 U.S. 133, 150 (2000)).

Appellants argue on appeal that it was error for the District Court to uphold and apply the exculpatory clause because it violates public policy. "Contracts may be avoided by the courts as against public policy only in cases free from doubt and where the injury to the public is clear." *Emory Univ. Porubiansky*, 282 S.E.2d 903, 904-905 (Ga. 1981) (*citing Phenix Ins. Co. v. Clay*, 28 S.E. 853 (Ga. 1897)). However, Appellants point to no case in Georgia holding that an exculpatory clause in an engagement letter from an accounting firm is violative of public policy. Rather, they analogize to other types of professionals, such as medical or dental professionals, who courts have held may not shield themselves from liability with an exculpatory clause. *See Porubiansky*, 282 S.E.2d at 905; *Olson v. Molzen*, 558 S.W.2d 429, 430 (Tenn. 1977). Appellants argue that, like doctors and dentists, accountants must be licensed in Georgia, and that the state has a valid interest in assuring that licensed accountants comport with the standards of care established for the profession. Further, they argue that the separate common law duty owed by D&D to the Appellants, arising apart from its contractual obligations, is unique to licensed professionals and supports a conclusion that they may not contract out of their obligation to exercise reasonable care.

However, this Court is not persuaded that the duties of an accountant are analogous to the duties of a medical or dental professional. In fact, courts within this Circuit have concluded that an exculpatory clause in a contract may be enforced, even where the contracting party, a securities broker, is a professional regulated by the state. *Barton v. Peterson*, 733 F.Supp.

1482, 1489 (N.D. Ga. 1990). In that case, the court emphasized that "the service is not one of practical necessity, nor are brokers generally willing to perform their services for any member of the public." *Id.* The court further reasoned that the parties were not of such unequal bargaining power to make the contract a contract of adhesion. *Id.* Likewise, in the instant case, Appellee D&D is a firm of financial professionals who provide accounting services to sophisticated clients with equal bargaining power. Unlike medical or dental services, accounting services are not a practical necessity. Furthermore, as D&D points out, there exists no state statute that specifies a duty of care for accountants, as there is for medical professionals. Given these distinct differences, we agree with the District Court that an exculpatory clause in a contract for the services of an accounting professional is enforceable.

Even if, as a general rule, exculpatory language eliminating the duty of care for accountants was unenforceable as a matter of public policy, the particular exculpatory clause at issue in this case would still be enforceable. This is because the exculpatory language used by D&D in its engagement letter does not eliminate the duty of care, or preclude legal action against D&D entirely, it simply limits the type of damages that may be sought. The *Porubiansky* decision, in fact, explicitly left the door open to the possibility that even medical or dental professionals could limit liability in some ways, "agree[ing] that because the clinic is part of a teaching facility it may require that prospective patients waive the right to insist on complete treatment." 282 S.E.2d at 904.

Thus, we agree with the District Court that the exculpatory language in D&D's engagement letter does not violate public policy and should be enforced. The District Court's entry of judgment as a matter of law in favor of Appellee D&D on the claims of professional negligence, ordinary and/or gross negligence, and breach of contract is affirmed.

VI. Attorneys' Fees, Prejudgment Interest, and Correction of Final Judgment

Finally, Appellants appeal the District Court's denial of attorneys' fees incurred in proving that D&D was negligent in auditing the Burnt Store financials, denial of TSG's request for pre-judgment interest, and award of attorneys' fees and costs to Bencini. The decision whether or not to award attorneys' fees based on D&D's refusal to stipulate is within the discretion of the District Court, and we find no abuse of discretion in this instance. Additionally, the issue of prejudgment interest is now moot in light of our affirmance of the District Court's entry of judgment as a matter of law in favor of D&D. Thus, these two orders of the District Court are affirmed. However, in light of our partial reversal of the order of summary judgment entered in favor of Bencini, we reverse the District Court's entry of Final Judgment in favor of Bencini for attorney's fees and costs, and remand the matter to the District Court for further proceedings.

VII. Conclusion

For the foregoing reasons, the District Court's denial of the plaintiff's motion to remand this case to

state court is AFFIRMED. The District Court's Order Granting Summary Judgment in favor of Bencini and D&D is VACATED in part as to the breach of fiduciary duty claim of all plaintiffs against Bencini, and the fraud and securities fraud claims of TSG and the inside investors against Bencini. These claims are REMANDED to the District Court for further proceedings consistent with this opinion. The District Court's Order granting judgment as a matter of law in favor of D&D on the claims of professional negligence, ordinary and/or gross negligence, and breach of contract is AFFIRMED. The District Court's Order denying the plaintiffs' request for attorneys' fees and prejudgment interest is AFFIRMED. The District Court's entry of final judgment in favor of Bencini for attorneys' fees and costs is VACATED and remanded to the District Court for further proceedings consistent with this opinion.

United States District Court
Southern District of Georgia

TSG WATER RESOURCES, INC. and TSG TECHNOLOGIES, INC.

v.

~~AMENDED JUDGMENT~~
IN A CIVIL CASE
CASE NUMBER: CV402-258

D'ALBA & DONOVAN CERTIFIED PUBLIC ACCOUNTANTS, P.C.

☒ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☐ Decision by Court. This action came before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED
the Court amends its Judgment of 2/1/06, and finds that in accordance with the Jury Verdict of 2/1/06, Plaintiff is entitled to internal damages of $270,000.00 and $15,300.00 for interest liability incurred on promissory notes from defendant D'Alba & Donovan Certified Public Accountants.

Approved by: /s/

5/5/06
Date

Scott L. Poff
Clerk

/s/ Walker Prescott
(By) Deputy Clerk

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

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TSG WATER RESOURCES, INC. et al,
Plaintiffs,

v. Case No. CV 402-258

D'ALBA & DONOVAN CERTIFIED PUBLIC ACCOUNTANTS, P.C. et al.
Defendants.

ORDER

Before the Court is Defendant Bencini's Motion for Entry of Final Judgment. (Doc. 220.) The Court finds that final judgment in favor of Defendant Bencini is appropriate, and hereby ORDERS that the Court's entry of judgment in favor of Bencini dated August 18, 2004 be made final for all purposes. Judgment is in favor of Bencini for costs and legal fees in the total amount of $111,439.15. The Court disagrees with TSG's conclusion that the award of $7,078.05 for costs is also included in the $104,361.10 award for legal fees and expenses. (Doc. 228.) A careful review of the

pleadings and their supporting documentation shows that these two awards constitute separate and independent costs incurred by Bencini in the course of these legal proceedings. The Court's judgment of August 18, 2004 and its total award of $111,439.15 is therefore reaffirmed and made final.

The Court ORDERS that Bencini be awarded prejudgment interest in the amount of $13,784.87. This award is based on the prejudgment interest rate of 7% mandated by Georgia law. O.C.G.A. § 7-4-2. Prejudgment interest is hereby awarded for the period of 645 days between July 26, 2004, when TSG's liability became fixed and certain by this Court's order, and May 2, 2006, when this Court deemed the judgment of August 18, 2004 to be final for purposes of appeal and collection.

Additionally, the Court ORDERS that the judgment in favor of Defendant D'Alba and Donovan of May 10, 2004, dismissing all claims of the individual investor Plaintiffs, be made the final judgment of this Court. Those individual investor Plaintiffs whose claims were dismissed are Donald Mayer, Paul Steward, Jonathan Sprague, Robert Bolz, John Bolz, William Holden and a OGM Family Limited Partnership. The judgment in respect to these Plaintiffs is made final for all purposes.

So ORDERED.

/s/
JOHN F. NANGLE
UNITED STATES DISTRICT JUDGE

Dated: May 2, 2006

United States District Court
Southern District of Georgia

TSG WATER RESOURCES, INC. and
TSG TECHNOLOGIES, INC.

JUDGMENT IN A CIVIL CASE

v. CASE NUMBER: 402-258

D'ALBA & DONOVAN CERTIFIED PUBLIC ACCOUNTANTS, P.C.

☒ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☐ Decision by Court. This action came before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED
that in accordance with the Jury Verdict of date 2/1/06, Plaintiff is entitled to internal damages of $300,000.00 and interest liability on promissory notes of $17,000.00 from defendant D'Alba & Donovan Certified Public Accountants.

Approved by: /s/

2/1/06
Date

Scott L. Poff
Clerk

/s/ Walker Prescott
(By) Deputy Clerk

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

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TSG WATER RESOURCES, INC. et al,
Plaintiffs,

v. Case No. CV 402-258

D'ALBA & DONOVAN CERTIFIED
PUBLIC ACCOUNTANTS, P.C. et al.
Defendants.

ORDER

Before the Court are Plaintiffs' Motion for Reconsideration and Defendant D'Alba and Donovan's Cross-Motion for Partial Reconsideration of the Court's Order dated May 10, 2004 (Docs. 127 & 131). After careful consideration, the Court DENIES both Plaintiffs' motion and D'Alba & Donovan's motion.

BACKGROUND

This diversity case involves claims arising from an audit of the TSG corporations ("TSG") for the year

2000. Plaintiffs sued Morris Bencini ("Bencini") and D'Alba & Donovan Certified Public Accountants, P.C. ("D&D") asserting claims of fraud and securities fraud against both Bencini and D&D, claims of breach of fiduciary duty against both Bencini and D&D, claims for negligence against D&D, claims of breach of contract and negligent retention and supervision against D&D, and claims for punitive damages and attorneys' fees against both Bencini and D&D.

Both Defendants filed motions for summary judgment on September 11, 2003. This Court ruled on those motions on May 5, 2004, granting in full Bencini's motion for summary judgment and granting in part and denying in part D&D's motion for summary judgment. The Court granted D&D's motion for summary judgment on all claims, except Plaintiffs' claims of negligence and breach of contract.

Plaintiffs filed a motion for reconsideration on May 20, 2004. Plaintiffs argue that the Court made clear errors of law in that (1) it erroneously held Bencini did not breach his fiduciary duty; (2) it erroneously held that Plaintiffs did not reasonably rely on financial information provided by Bencini and D&D; and (3) it erroneously held that the investors did not rely on the financial statements provided by Bencini and D&D. In the event the Court denies their motion for reconsideration, Plaintiffs request that the Court certify its May 10, 2004 Order for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

Both Defendants filed responses to Plaintiffs' motion on June 4, 2004. D&D also filed a cross-motion

for partial reconsideration, wherein it asks the Court to rule that the only damages available to Plaintiffs for its claims of negligence and breach of contract are damages related to the fees actually paid for the year 2000 audit and the money spent to have TSG re-audited. Plaintiffs filed a response to D&D's cross-motion for partial reconsideration on June 21, 2004.

ANALYSIS

I. Motions for Reconsideration

While the Federal Rules of Civil Procedure do not specifically provide for motions for reconsideration, because its May 10, 2004 Order is an interlocutory order, the Court "may reconsider or reverse its decision for any reason it deems sufficient." *Canaday v. Houshold Retail Servs., Inc.,* 119 F. Supp. 2d 1258, 1260 (M.D. Ala 2000) (citing *Bon Air Hotel, Inc. v. Time*, 426 F.2d 858, 862 (5th Cir. 1970)); *Winfrey v. School Board*, 59 F.3d 155, 157 (11th Cir. 1995)("[A] partial disposition of a multiclaim or multiparty action does not qualify as a final judgment ... and is ordinarily an unappealable interlocutory order.")(internal quotations and citation omitted). However, in ruling on a motion for reconsideration, "the Court must balance its duty to render just decisions with the need for finality." *Brogdon Ex Rel. Cline v. Nat'l Healthcare Corp.*,103 F. Supp. 2d 1322, 1338 (N.D. Ga. 2000)(citing *McCoy v. Macon Water Auth..,* 966 F. Supp. 1209, 1222 (M.D. Ga. 1997). So that the Court may

> accommodate these competing interests, this Court will grant a motion for reconsideration of an interlocutory order only if the movant demonstrates that there has been an intervening change in the law, that new evidence has been discovered which was not previously available to the parties in the exercise of due diligence, or that the court made a clear error of law.

McCoy, 966 F. Supp. at 1222-23.

A. Plaintiffs' motion

Plaintiffs' motion for reconsideration argues several reasons for revising the Court's May 10, 2004 Order. These arguments are merely refinements or restatements of arguments previously made, and do not merit reconsideration. *Id.* at 1223 (stating that for movants to demonstrate clear error, they "must do more than simply restate [their] prior arguments, and any arguments which [they] inadvertently failed to raise earlier are deemed waived.")(citing *Mateo v. M/S Kiso*, 805 F. Supp. 761, 787 (N.D. Cal.1991)); *accord, Garcia v. United States*, 2002 U.S. Dist. LEXIS 23962, at *2 (S.D. Fla Nov. 4, 2002); *Matasantos Comm. Corp. v. Applebee's Int'l, Inc.*, 245 F.3d 1203, 1209 n. 2 (10th Cir. 2001). The Court, having thoroughly reviewed the record and carefully considered the law, DENIES Plaintiffs' motion for reconsideration.

B. D&D's motion

In its cross-motion for partial reconsideration, D&D asks the Court to rule that the only potential damages available to TSG for its claims of negligence and breach of contract are (1) the fees TSG actually paid for the year 2000 audit and (2) the fees TSG paid to have the year 2000 financial statements re-audited. In its May 10, 2004 Order, the Court held that most of the damages claimed by TSG did not proximately flow from alleged misrepresentations or omissions contained in D&D's audit and financial statements. *See* May 10, 2004 Order at 10-15. D&D argues that if TSG cannot recover consequential damages on their fraud claims, they cannot recover consequential damages on their negligence or breach of contract claims. After carefully reviewing the record and the law, the Court holds that the damages TSG may recover for its negligence and breach of contract claims will be limited to those damages proven at trial. Accordingly, D&D's cross-motion for reconsideration is DENIED.

II. Interlocutory appeal

An interlocutory appeal is allowed under 28 U.S.C. § 1292(b)

> [w]hen a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is a substantial ground for

> difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation[.]

28 U.S.C. § 1292(b). Thus, there are essentially three requirements that must be satisfied before a district court may certify an order for interlocutory appeal: (1) the order must involve a controlling question of law, (2) as to which there is substantial ground for difference of opinion, and (3) an immediate appeal from the order may materially advance the ultimate termination of the litigation. *Id.; Harris v. Luckey*, 918 F.2d 888, 892 (11th Cir. 1990). "Exceptional circumstances are required to justify a departure from the policy of postponing appellate review until after the entry of a final judgment." *Carley Capital Group v. Deloitte & Touche, LLP,* 1999 WL 816963, *4 (N.D. Ga. 1999).

Plaintiffs argue that an interlocutory appeal is appropriate in this instance because the issue of whether D&D was a fiduciary to TSG is controlling, in that resolution of this issue dictates the level of inquiry necessary on the part of TSG in order to maintain its action for negligence against D&D. Even if the issue of whether D&D was a fiduciary to TSG was controlling in this case, Plaintiffs have failed to overcome the Eleventh Circuit's "strong presumption against interlocutory appeals." *See United States v. One Parcel of Real Property*, 767 F.2d 1495, 1498 (11th Cir. 1985). Plaintiffs have not shown that "there is a substantial ground for difference of opinion" or how an interlocutory appeal would "materially advance the

ultimate termination of the litigation."

In its May 10, 2004 Order, this Court held that no fiduciary relationship existed between D&D and TSG. After thoroughly researching this issue, the Court found that in most situations, accountants hired to audit financial statements of a client are not fiduciaries of the client, but rather are required to be independent of the client. *See, e.g., Resolution Trust Corp. v. KPMG Peat Marwick,* 844 F. Supp. 431, 436 (N.D. Ill. 1994)(holding independent auditor not in fiduciary relationship with client); *FDIC v. Schoenberger,* 781 F. Supp. 1155, 1157 (E.D. La. 1992)(finding accountants do not owe fiduciary duty to clients when providing services as auditors); *Franklin Supply Co. v. Tolman*, 454 F.2d 1059, 1065 (9th Cir. 1971)(holding accounting firm not in fiduciary relationship with client); *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP,* 110 Wash. App. 412, 434, 40 P.3d 1206, 1218 (2002)(holding absent special circumstances, auditor is not fiduciary of client). Plaintiffs have presented no facts or legal authority demonstrating that there is "a substantial ground for difference of opinion" on this issue. Instead, they merely rely on unpersuasive conclusory statements. Moreover, as this case is ready for trial, the Court finds certification under § 1292(b) is inappropriate because an appeal will not materially advance the ultimate termination of the litigation. Requiring Plaintiffs to wait until after trial to pursue an appeal will not cause any substantial delay.

So ORDERED.

/s/
JOHN F. NANGLE
UNITED STATES DISTRICT JUDGE

Dated: July 23, 2004

UNITED STATES DISTRICT COURT
Southern District of Georgia

Case Number:	4:02-cv-00258
Date Served:	July 23, 2004
Served By:	Betsy C. West

Attorneys Served:

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Brent J. Savage, Esq.
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✓ Copy placed in Minutes
✓ Copy given to Judge
___ Copy given to Magistrate

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

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TSG WATER RESOURCES, INC. et al,
Plaintiffs,

v. Case No. CV 402-258

D'ALBA & DONOVAN CERTIFIED
PUBLIC ACCOUNTANTS, P.C. et al.
Defendants.

ORDER

In this diversity case, Plaintiffs are suing Morris Bencini ("Bencini") and D'Alba & Donovan Certified Public Accountants, P.C. ("D&D") on numerous claims arising from an audit of the TSG corporations for the year 2000. Plaintiffs have asserted claims of fraud and securities fraud against both Bencini and D&D (Count V), claims of breach of fiduciary duty against both Bencini and D&D (Counts II & III), claims for negligence against D&D (Counts I & IV), claims of breach of contract and negligent retention and supervision against D&D (Counts VI & VII), and

claims for punitive damages and attorneys' fees against both Bencini and D&D (Counts VIII & IX).

Plaintiffs can be placed into three groups. The first group includes TSG Water Resources, Inc. and its wholly-owned subsidiary, TSG Technologies, Inc. (collectively, "TSG"). Defendant Bencini is a former vice-president and chief financial officer ("CFO") of TSG and held those positions from around July 1999 until June 2001. The second group of plaintiffs ("Inside Investors") consists of Donald Mayer,[1] Paul Steward,[2] and Jonathan Sprague.[3] These individuals were all Directors of TSG during the time at issue in this suit and are all currently Directors. The third group ("Outside Investors") consists of Robert Bolz,[4] John

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[1]While Bencini was employed by TSG, Mayer was a Director and shareholder of TSG, and is now a vice-president of TSG. He is suing for losses resulting from investments in TSG totaling $450,000.

[2]Steward was a Director and shareholder of TSG during Bencini's employment. He is suing for losses resulting from investments in TSG totaling $500,000.

[3]Sprague was General Counsel, a vice-president, a shareholder, and a Director of TSG during Bencini's employment, and he is currently the President of TSG. He is suing for losses resulting from investments in TSG totaling $125,000.

[4]Robert Bolz is suing for losses resulting from a $50,000 investment in TSG.

Bolz,[5] William Holden,[6] and OGM Family Limited Partnership ("OGM").[7] These investors were friends and family members of Mayer.

Before the Court are Defendant Bencini's Motion for Summary Judgment (Doc. 93), Defendant D&D's Motion for Summary Judgment (Doc. 71), and Defendant Bencini's Motion for Advance of Legal Fees and Expenses (Doc. 66). Also before the Court are Plaintiffs' Motion for Oral Argument (Doc. 118) and Motion for Reconsideration (Doc. 124).

BACKGROUND

The submissions of the parties, including the Statements of Undisputed Facts of Bencini (Doc. 96) and D&D (Doc. 73), Plaintiffs' Responses to both (Docs. 108 & 110), exhibits, and deposition testimony, establish the following facts.

TSG is a relatively small Savannah-based company that designs and builds waste water treatment facilities and desalination plants in the southeastern United States and Caribbean. In addition to designing and building plants, TSG generates

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[5]John Bolz is suing for losses resulting from a $50,000 investment in TSG.

[6]William Holden is suing for losses resulting from a $100,000 investment in TSG.

[7]OGM is a partnership consisting of Don Mayer and his two brothers. It is suing for losses resulting from investments in TSG totaling $200,000.

recurring monthly revenue from the operation of some of those facilities. Because this recurring revenue is not enough to cover its operating expenses, TSG depends on major design-build projects to produce revenue. Since its founding in 1993, TSG has had difficulty turning a profit. TSG lost approximately $404,000 in 1996; $613,000 in 1997; $1,118,000 in 1998; and $855,138 in 1999. As far back as 1998, TSG received capital from various Plaintiffs to cover its losses. In addition to these cash infusions, TSG has also depended on a $1.5 million credit line from Darby Bank in Savannah ("Darby credit line") along with other financing. TSG's reliance on financial support from insiders continued throughout 2001, 2002, and 2003.

Year 2000 audit

TSG hired D&D, a New York-based accounting firm, to review and audit TSG's financial statements for the year ending December 2000 and to file certain tax returns.[8] To carry out the audit, D&D was given access to TSG's books and records. Plaintiffs admit that TSG provided the auditors with "full, complete and accurate information concerning all aspects of the company's finances and status of various projects," and the "core financial information from the [year 2000]

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[8]In the engagement letter dated November 27, 2000 ("Engagement Letter"), D&D agreed to prepare a consolidated federal tax return for TSG and its includible subsidiaries, the federal and required state tax returns for TSG Water, and all required state income tax returns for TSG and its includible subsidiaries. The engagement letter says nothing about tax returns for the U.S. Virgin Islands.

general ledger" prepared while Bencini was CFO was accurate. See Doc. 96, ¶¶ 18, 50. On April 27, 2001, D&D issued its Report of Independent Accountants and Consolidated Financial Statements for the year 2000 ("Financial Statements").

The Financial Statements showed that, in 2000, TSG and its subsidiaries had a pretax loss of $122,074. However, TSG recognized a gross deferred tax asset of about $680,000, accounting for the possibility that at some point in the future, TSG would be able to use its losses in past years to offset an income tax liability incurred on future profits. After discussions with TSG management, D&D agreed to reduce the $680,000 to a $191,000 net deferred tax asset and add it to the company's $122,074 loss, yielding a net income of $68,926. Despite this apparent net income, the Financial Statements were clear: TSG had a year 2000 deficit of $2,984,511.

TSG's financial crisis

By January 2001, TSG had created a new subsidiary called Progressive Composite Technologies ("PCT"), and the TSG Board of Directors ("Board") raised $200,000 in loans and also opened an additional $1 million line of credit for PCT. TSG had projected positive cash flows for PCT in 2001, but PCT turned out to be a cash drain, requiring numerous infusions of cash. Not unexpectedly, PCT's cash flow troubles affected TSG.

During the first half of 2001, it became apparent that TSG was suffering financially. According to

internal financial statements, through May 31, 2001, TSG registered a net loss of $782,171. TSG's troublesome financial situation was largely caused by two things: its unusually high operating costs and a dearth of large projects under contract. The "burn rate" – fixed non-project related costs such as salaries, rents, utilities, employee benefits – in the year 2000 was approximately $330,000 per month,[9] Absent large contracts, TSG lacked the cash to cover its "burn rate." By summer 2001, most of TSG's monthly expenses consisted of paying salaries and servicing its debt.

As June 2001 approached, the Burnt Store project,[10] TSG's sole project during the first half of 2001,[11] had almost been completed, and the $200,000 in loans raised for PCT and the $1.5 million Darby credit line were coming due. TSG's accounts payable continued to grow, and a subcontractor was

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[9]For a company of its size, TSG paid its executives very large salaries. TSG paid Bencini $170,000 per year, general counsel Sprague $180,000 per year, and its former President James Walker over $300,000 per year. TSG also incurred expenses for such things as an apartment in Savannah for traveling employees, Walker's $40,000 a year company vehicle, a cigarette boat in the Caribbean, and Walker's memberships in the Chatham Club, the Landings Golf Club and the St. Thomas Yacht Club.

[10]Burnt Store was a design and build of a water purification facility located in Florida. According to Plaintiffs, it was the largest in the history of TSG in terms of both project scale and projected revenues.

[11]TSG had contracted a design-build project for the Ritz Carlton in St. Thomas and construction was to begin in late summer or early fall 2001.

threatening to place a lien on the Burnt Store project. Bencini reported TSG's impending financial crisis to James Walker, who was President, Chairman of the Board, and majority and controlling shareholder of TSG, and Sprague. Bencini also prepared various cash flow projections and financial reports ("Reports") regarding TSG's operations to analyze the problem. Bencini provided these Reports to Sprague in his capacity as Vice-President, General Counsel, and Director of TSG. One report was a Consolidated TSG Financial Statement showing a net loss of $644,361 for the period ended March 31, 2001. Another report was a Cash Forecast through June 30, 2001, showing a deficit of $770,149. Bencini also created a Cash Forecast through the end of 2001 showing an ending cash balance of $1,995,878 on June 15, 2001, and the need for an immediate infusion of $500,000 to continue operations. All of these Reports provided a gloomy outlook ahead for TSG.

In addition to preparing the Reports showing TSG's distressed financial condition, Bencini proposed cost-cutting measures, including salary reductions for both Walker and Sprague. Bencini also advised Walker that he was resigning to take a long-standing job offer from another company, explaining that TSG could not afford or justify a CFO.

The emergency board meeting

Because TSG was facing a severe financial crisis, an emergency board meeting was called for June 15, 2001 ("June 15 meeting"). In preparation for the meeting, Mayer and Steward made arrangements for

an immediate loan to TSG in the aggregate amount of $500,000, Sprague undertook responsibility to prepare a memorandum outlining the causes and possible remedies for the financial crisis, and Walker undertook to prepare a cash flow projection to demonstrate TSG was still viable if the loans were approved by the Board. Plaintiffs Mayer, Steward, and Sprague were all present at the June 15 meeting. Bencini, who was not invited, did not attend that meeting.

The Inside Investors admit they were "shocked" and "horrified" at the June 15 meeting when they learned the financial condition of TSG. The Board was told that TSG was "upside-down" – that its accounts payable had reached an extremely high level. TSG was looking at a negative cash balance of almost $2 million for the week of June 22, 2001. An internal TSG document shows that the Board identified and discussed as reasons for this severe cash crunch (1) the loss of the Kiawah project, (2) the absence of any major projects under contract other than Burnt Store in the first half of 2001,[12] (3) the cash required by PCT, and (4) investments in an additional winder and mandrels for PCT. At the June 15 meeting, the Board did not review D&D's audit report or the Financial Statements but instead focused on "the existing and future situation, rather than the historical one." See Doc. 73, ¶ 16.

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[12]As mentioned previously, TSG had signed a contract for Ritz Carlton with construction to begin in late summer or early fall 2001.

The Board and Walker were hoping for contracts for the Marco Shores and Frenchman's Reef projects to help TSG get out of the financial crunch it was in. At the June 15 meeting, Walker presented a "Cash Flow Forecast"[13] which indicated that if TSG could borrow $500,000 and obtain the Marco Shores and Frenchman's Reef project, then it could end 2001 with a negative cash flow of only $89,000. The Marco Shores and Frenchman's Reef projects were not under contract on June 15, 2001, and they were never ultimately signed.

Those who attended the June 15 meeting understood that TSG would fail and go out of business without immediate and substantial loans. When Plaintiffs Mayer, Steward, and Sprague lent money to TSG, they knew that without the loans the company would fail, and they also knew that the future of TSG depended on its obtaining the large new contracts at Marco Shores and Frenchman's Reef.

It is undisputed that without the immediate cash infusion of $500,000 in June 2001, TSG would have gone out of business. If TSG failed, then several Plaintiffs would have been called to satisfy personal guarantees on certain debts of TSG and its subsidiaries. Plaintiff Sprague had personally guaranteed up to $250,000 of TSG's debt. Plaintiff Mayer had personally guaranteed at least half of TSG's fully drawn $1.5 million Darby credit line, the entirety of a $1.5 million loan from TSG to PCT, and

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[13]Walker revised Bencini's 2001 year-end Cash Forecast document for presentation at the June 15 meeting.

one third of a $750,000 personal guarantee of Plaintiff Steward. Plaintiff Steward had personally guaranteed up to $1 million of PCT's debt, and TSG still owed him around $250,000. These three Plaintiffs had a substantial and personal reason to keep TSG afloat. In fact, Sprague testified in his March 11, 2003 deposition that loaning TSG $100,000 in 2001 rather than losing $250,000 in guarantees played a role in his decision to invest.

Solicitation of funds

It was against this backdrop that the Board authorized TSG to borrow up to $1 million, and Mayer was designated the person to raise money from outside investors. When he solicited loans from family and friends, Mayer did not furnish them with copies of the Financial Statements. Neither did he describe or provide the financial reports and information discussed at the June 15 meeting. The Outside Investors admit that they trusted Mayer and relied solely on his request for the funds. The Outside Investors never saw or relied on the Financial Statements.

Sale of PCT

With 2001 coming to an end, TSG never obtained the Marco Shores or Frenchman's Reef contracts and continued to struggle financially. TSG also decided to sell its interest in PCT, and in August 2001, entered negotiations with Bekaert Corporation ("Bekaert") to unload PCT. TSG and Bekaert discussed selling TSG's interest in PCT to Bekaert for between

three to ten million dollars. Walker had estimated its worth at $7.5 million.

PCT was eventually sold to Bekaert for $4.9 million, with a $3 million "earn-out" provision, meaning Bekaert will pay up to an additional $3 million if PCT meets certain revenue targets. TSG expects to receive the $3 million "earn-out" on PCT, making the total return on the sale approximately $7.9 million. Before the sale was completed, TSG hired an appraisal firm to give an opinion on the fairness of the sales price, and the appraisal firm "opined that it was a fair transaction" for TSG. During the sales negotiations that lasted from September 2001 until the sale closed in April 2002, TSG never tried to market PCT to anyone else. In this suit, Plaintiffs seek damages for the alleged distressed sale of PCT.

The fallout

Heading into the winter of 2001, Mayer and others concluded that Walker was the true source of the company's struggles.[14] By November 2001, Mayer, Sprague and the other directors had completed steps to dilute Walker's interest and remove him as President and Chairman of the Board. Thereafter, TSG retained counsel to evaluate claims against Walker for mismanagement and fraud. As a result of

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[14]Until November 2001, Walker, as TSG's president and majority shareholder, had authority to make employment decisions, to set company policy for vehicle, travel, and discretionary expenses, and to lease space for TSG companies. As such, his "tendency was to expend money now planning for rapid future growth."

the investigation, the Directors concluded that Walker, while majority shareholder, President, and Chairman of the Board, had engaged in acts of mismanagement and concealed the companies' financial condition. TSG and Walker eventually entered into an agreement settling all of their disputes. Some have testified that they believe Walker to be the cause of TSG's financial difficulties.

On August 1, 2002, the Investor Plaintiffs and TSG Water filed suit in the Southern District of Georgia against D&D only. That suit was dismissed without prejudice after service on D&D was never perfected. *See TSG Water Resources, Inc. v. D'Alba and Donovan,* CV 402-179. When the present captioned lawsuit was filed on October 24, 2002, in the State Court of Chatham County, Georgia, Plaintiffs added TSG Technologies as a plaintiff and Bencini as a defendant, alleging that both were Florida citizens. On December 4, 2002, Defendants jointly removed this matter to this Court. Plaintiffs subsequently filed a motion to remand asserting lack of subject matter jurisdiction. This Court denied that motion.

PLAINTIFFS' MOTIONS

Plaintiffs request a hearing to present oral arguments on Defendants' motions for summary judgment and Plaintiffs' responses thereto (Doc. 118). Because the Court was able to rule on Defendants' motions on the pleadings, the Court finds it unnecessary to hear oral arguments on these motions. Accordingly, the Court DENIES Plaintiffs' motion for oral argument.

Plaintiffs also move the Court to reconsider its December 19, 2003 Order denying them leave to file supplemental briefs in opposition to Defendants' motions for summary judgment (Doc. 122). The Court affirms its previous order and DENIES Plaintiffs' motion for reconsideration.

SUMMARY JUDGMENT MOTIONS

Defendants Bencini and D&D move this Court to dismiss all of Plaintiffs' pending claims against them.

I. Summary Judgment Standard

Summary judgment serves to "pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial," FED. R. cv. P. 56 advisory committee's note, *cited in Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*,475 U.S. 574, 587 (1986). It is appropriate only when the pleadings, depositions, and affidavits submitted by the parties indicate no genuine issue of material fact and show that the moving party is entitled to judgment as a matter of law. FED. R. cv. P. 56(c). A court must view the evidence and any inferences that may be drawn from it in the light most favorable to the nonmoving. *Combs v. Plantation Patterns,* 106 F.3d 1519, 1526 (11th Cir. 1997), *cert. denied sub nom. Combs v. Meadowcraft Co.,* 522 U.S. 1045 (1998) (citing *Carter v. City of Miami,* 870 F.2d 578, 581 (11th Cir. 1989)).

The party seeking summary judgment must first identify grounds demonstrating the absence of a

genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *Thompson v. Metro. Multi List, Inc.*, 934 F.2d 1566, 1583 n.16 (11th Cir. 1991), *cert, denied,* 506 U.S. 903 (1992). Such a showing shifts to the non-moving party the burden "to go beyond the pleadings and by ... affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Celotex*, 477 U.S. at 324 (quoting Fed R. Civ. P. 56(e)).; *Thompson*, 934 F.2d at 1583 n.16. A non-movant does not create a genuine issue of material fact by relying on "conclusory allegations based on mere subjective beliefs." *Plaisance v. Travelers Ins. Co.*, 880 F. Supp. 798, 804 (N.D. Ga. 1994), *aff'd,* 56 F.3d 1391 (11th Cir. 1995) (citing *Carter*, 870 F.2d at 585). Further, a "mere scintilla of evidence in support of the [non-movant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [non-movant]." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986).

II. Fraud/Securities Fraud Claims (Count V)

A. Substance of claims

Plaintiffs allege that D&D and Bencini conspired to misinform Plaintiffs of the true financial condition of TSG for the purpose of presenting an optimistic depiction of TSG's finances and inducing Plaintiffs to purchase securities offered by TSG. According to Plaintiffs, this conspiracy culminated in the release of the Financial Statements, which incorrectly and materially overstated TSG's earnings

for the year 2000. Plaintiffs further allege that they justifiably relied upon the Financial Statements to their harm and detriment.

B. Discussion

The tort of fraud has five essential elements: (1) false representation by a defendant; (2) scienter; (3) intention to induce the plaintiff to act or refrain from acting in reliance upon the representation; (4) justifiable reliance by the plaintiff upon the representation; and (5) damage to the plaintiff directly and proximately caused by the reliance. *Middleton v. Troy Young Realty, Inc.*, 257 Ga. App. 771, 772, 572 S.E.2d 334, 336 (2002); *Reeves v. Edge*, 225 Ga. App. 615, 617-18, 484 S.E.2d 498, 501 (1997). To prove securities fraud under Georgia law, a plaintiff must show (1) a misstatement or omission, (2) of a material fact, (3) made with scienter, (4) on which the plaintiff relied, (5) that proximately caused his injury. *GCA Strategic Inv. Fund, Ltd. v. Joseph Charles & Assocs., Inc.*, 245 Ga. App. 460, 464, 537 S.E.2d 677, 682 (2000).

1. No proximate cause

"Although the question of proximate cause is ordinarily for the jury to decide, plain and indisputable cases may be decided by the court as a matter of law. In such plain cases, the inquiry is whether the causal connection between the defendant's conduct and the injury is too remote for the law to countenance a recovery." *Thomas v. Food Lion, LLC*, 256 Ga. App. 880, 883, 570 S.E.2d 18, 21 (2002). The Court finds

this is one of those plain and indisputable cases.

The Court finds that the damages claimed by TSG did not, as a matter of law, proximately flow from alleged misrepresentations contained in D&D's audit and Financial Statements. The alleged damages were too far removed and there were too many intervening causes. The financial mess into which TSG had fallen was not a result of erroneous Financial Statements, but instead a result of TSG's high expenses and no major income generation. Walker, as TSG's president and majority shareholder, had the authority to make employment decisions and set company policy on discretionary spending. There is no evidence to suggest that he would have changed TSG's spending policies had he known that the Financial Statements were erroneous. In fact, there is no evidence to suggest his decisions were at all influenced by the Financial Statements. The Financial Statements were, by May 2001, almost irrelevant to TSG's cash flow problems. TSG had amassed a deficit approaching $700,000 by that time and needed new design projects to remain viable.

Walker had access to updated 2001 financial data, and many interim reports had been produced showing the negative cash flows of TSG. Walker knew or should have known about TSG's precarious financial position, but failed to reduce expenditures. Walker's failure to change spending habits or his decision not to inform board cannot be imputed to D&D or Bencini. TSG, as any rationally run business, had an economic incentive to minimize its unnecessary expenses with or without an audit report. The record contains no

evidence that Walker would have done anything differently, and without this evidence there is nothing to causally connect TSG' s claimed damages to D&D's audit report.

Although they claim that if they had been provided a true and accurate financial picture of TSG, they would not have continued to allow Walker to continue operations as he had been, Plaintiffs have presented no evidence to show how the Board would have been able to do this. In fact, the vehicle through which Walker's control was finally severed was the dilution of shares caused by the investment capital of the Investor Plaintiffs. There is no evidence in the record to suggest that Walker would have voluntarily relinquished control of TSG in Mayor June 2001. Plaintiffs' "belief" that he would have lost control earlier than he did does not create a genuine issue of material fact. *See Pace v. Capobianco,* 283 F.3d 1275, 1278-79 (11th Cir. 2002)("an affidavit stating only that the affiant 'believes' a certain fact exists is insufficient to defeat summary judgment...."). Any damages TSG allegedly sustained as a result of erroneous Financial Statements relate to the contract price paid for the audit and the money spent to have TSG re-audited, not to damages that flowed from alleged misrepresentations or omissions.

2. No justifiable reliance

Both fraud and securities fraud require a similar finding of justifiable reliance on the part of Plaintiffs, *GCA Strategic Inv. Fund,* 245 Ga. App. at 464, so the Court addresses these claims together. "To

show justifiable reliance on the misrepresented or omitted information sufficient to constitute securities fraud, [plaintiffs] must show that 'with the exercise of reasonable diligence [they] still could not have discovered the truth behind the fraudulent omission or misrepresentation.'" *GCA Strategic Inv. Fund*, 245 Ga. App. at 464 (quoting *Gochnauer v. A.G. Edwards & Sons*, 810 F.2d 1042, 1047 (11th Cir. 1987). To prove justifiable reliance for fraud, Plaintiffs must show that they exercised their duty of due diligence. *Reeves*, 225 Ga. App. at 618. While questions of due diligence often must be resolved by the trier of fact, one may fail to exercise due diligence as a matter of law. *Fowler v. Overby,* 223 Ga. App. 803, 804, 478 S.E.2d 919, 921 (1996). "The law does not afford relief to one who suffers by not using the ordinary means of information, whether the neglect is due to indifference or credulity." *Fann v. Mills*, 248 Ga. App. 460, 463, 546 S.E.2d 853, 857 (2001). The record contains no evidence showing there was justifiable reliance on the part of the Investor Plaintiffs.

a. Inside Investors

After reviewing the record, the Court questions whether the Inside Investors actually relied on the Financial Statements at all when making their decision to invest in TSG in the summer of 2001. However, viewing the evidence most favorably to the Inside Investors, and assuming they did rely on the Financial Statements, it is nonetheless clear that they did not justifiably rely upon them. Reliance upon the Financial Statements alone would not be sufficient to reach the threshold level of due or reasonable

diligence. As the Georgia Court of Appeals explained,

> the ultimate decision to invest is often based on a number of factors that have little to do with an accountant's audit report. After all, an auditing Certified Public Accountant rarely examines every aspect of a client's business, has little or no expertise or control over a client[']s products, services, or markets, and does not choose or control the client's executives or make its business decisions .... Thus, an investment decision based solely or primarily on an accountant's audit report would be, in most cases, difficult to justify .... Moreover, [a]s a matter of economic and social policy, third parties should be encouraged to rely on their own prudence, diligence, and contracting power, as well as other informational tools. This kind of self-reliance promotes sound investment and credit practices and discourages the careless use of monetary resources. If, instead, third parties are simply permitted to recover from the auditor for mistakes in the client's financial statements, the auditor becomes, in effect, an insurer of not only the financial statements, but of bad loans and investments [as well].

White v. BDO Seidman, LLP, 249 Ga. App. 668, 672-73, 549 S.E.2d 490, 494 (2001)(internal citations

and quotations omitted).[15]

The Inside Investors were all present at the June 15 meeting where the Board discussed the financial problems that had befallen TSG, and they were aware of the bleak outlook that potentially lay ahead.[16] If it did not receive a cash infusion of $500,000 and obtain the Marco Shores and Frenchman's Reef projects, then TSG was projected to have a negative cash balance of almost $2 million by the end of 2001. Steward admits in deposition testimony that, based on the detailed presentation of the financial situation and cash requirements of TSG by Sprague and Walker at the June 15 meeting, he and the other board members had a fair and accurate understanding of TSG's financial condition as of June 15, 2001. Sprague admits that before he made any loans in June 2001, he was aware of TSG's then-current financial situation. Mayer admits that he, along with the other directors at the June 15 meeting, knew that neither Marco Shores nor Frenchman's Reef were under contract at that date, and Mayer admits that he knew of the risk of not getting those projects. Mayer also admits that there had been a substantial change of circumstances relating to the financial

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[15]Although White discusses justifiable reliance in the context of negligent misrepresentation, Georgia Courts engage similar analysis when addressing fraud. *See e.g., Paul v. Destito*, 250 Ga. App. 631, 550 S.E.2d 739 (2001); *Real Estate Int'l. Inc. v. Buggay*, 220 Ga. App. 449, 469 S.E.2d 242 (1996).

[16]The Court finds unpersuasive Plaintiffs' attempts to characterize TSG's June 2001 severe cash flow problem as a short-term cash shortfall.

condition of TSG from December 2000 to June 2001.

It appears that, in this instance, the Inside Investors' rosy expectations of TSG's future clouded their judgment. They had sufficient notice to be put on inquiry to further explore the financial health of TSG before making any more investments in the company. "Notice sufficient to excite attention and put a party on inquiry shall be notice of everything to which it is afterwards found such inquiry might have led. Ignorance of a fact, due to negligence, shall be equivalent to knowledge, in fixing the rights of the parties." *Real Estate Int'l. Inc. v. Buggay,* 220 Ga. App. 449, 452, 469 S.E.2d 242, 245 (1996). Given the information known by and available to them, the Inside Investors failed, as a matter of law, to exercise due or reasonable diligence. Thus, any damage they may have suffered as a result of the Financial Statements is attributable to their own lack of diligence and not to their justifiable reliance upon any alleged misrepresentation contained in the Financial Statements. The Inside Investors claims for fraud and securities fraud fail as a matter of law.

b. Outside Investors

The Outside Investors have admitted in deposition testimony that they did not actually rely on the Financial Statements when deciding to invest in TSG in the summer of 2001. Plaintiffs Holden, John Bolz, and Robert Bolz have stated that they did not rely on any financial statements produced by Bencini or D&D, and instead relied solely on the representations and recommendation of Plaintiff

Mayer.[17] The OGM partnership, consisting of Plaintiff Mayer and his two brothers, likewise relied solely on Mayer's assurances that TSG had turned a corner when deciding to invest in TSG in summer 2001.[18] However, even assuming that the Outside Investors relied on the Financial Statements, and viewing all inferences in favor of the Outside Investors, the record clearly shows that these Plaintiffs failed to exercise due or reasonable diligence. The Outside Investors were not your average investors – they were all sophisticated businessmen in their own right.[19] As

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[17]The Outside Investors all admit that they relied solely or primarily on the recommendation of Mayer in making their investment decision. Their argument of "indirect reliance" through Mayer is seemingly precluded by *White*, 249 Ga. App. at 671-672 (rejecting indirect reliance theory and requiring actual reliance in negligent misrepresentation claim against accounting firm).

[18]Mayer stated in deposition testimony that when talking to his brothers about this investment, he did not discuss the 2001 financial status of TSG.

[19]John Bolz has a degree in economics and is the investment advisor and manager (and has been for about 20 years) of a family trust with assets in excess of $1 million. Robert Bolz attended Harvard Business school for one year, was an accredited investor in the summer of 2001 as defined by federal securities law, and had previously served as a vice-chairman of the board of Oscar Mayer. Holden has a degree in business, is an accredited investor as defined by federal securities law, and has served as the CEO of at least two companies, as well as serving on the board of directors of Wachovia Bank. Mayer has a bachelor's degree in general studies and economics from Harvard University, has a master of science in business and labor relations, and a law degree from the University of Michigan Law School. Mayer has served as vice president and general counsel of Gulfstream and has been involved in several entrepreneurial ventures.

such, a greater diligence is required before reliance may be considered justified. *See William Goldberg & Co. v. Cohen,* 219 Ga. App. 628, 631,466 S.E.2d 872, 877 (1995); *GCA Strategic Inv. Fund*, 245 Ga. App. at 465. The record is totally devoid of evidence of any efforts made by the Outside Investors to independently verify any statements made by Mayer, let alone to verify the unseen Financial Statements. The Outside Investors did not rely on any documents or ask for internal financial statements when making their decision to loan money to TSG. At least six months had passed since the period covered by the Financial Statements by the time the Outside Investors were called upon to invest in TSG in summer 2001. But the Outside Investors did not inquire into the financial condition of TSG in the summer of 2001. John Bolz knew when he made the July 2001 investment that TSG had not yet repaid the loan he made in January 2001. And at the time of the July 2001 investment, Mayer told him "very little" about the financial condition of TSG. Robert Bolz relied on Mayer's assurances that TSG had turned around financially. He did not ask to see any proof. Robert Bolz did not consult any financial advisors or anyone else before making this July 2001 investment. Holden admitted in deposition testimony that he "basically made [his] decision on what [Mayer] was telling [him]." Holden Dep. at 9. He did not ask for a prospectus, he did not talk to Mayer about any of TSG's internal financial statements, and he did not ask to see TSG's books or records.

The record reveals, unquestionably, that the Outside Investors did not exercise due diligence. Thus,

there is no genuine issue of material fact concerning whether they justifiably relied on D&D's audit or the Financial Statements when they invested in TSG in the summer of 2001. Accordingly, the Outside Investors' fraud and securities fraud claims against Bencini and D&D fail as a matter of law.

3. No intent

Plaintiffs have also failed to present sufficient evidence to create a genuine issue of material fact as to the requisite intent for their fraud claim. Assuming that Bencini and D&D had the requisite scienter in the production of the Financial Statements, the record contains no evidence that D&D or Bencini intended to induce TSG or the Investor Plaintiffs to act or refrain from acting in reliance upon the Financial Statements. "A misrepresentation is intended to deceive where there is intent that the representation be acted upon by the other party." *Petzelt v. Tewes*, 260 Ga. App. 802, 805, 581 S.E.2d 345, 347 (2003). There is no evidence to support the claim that Bencini and D&D knew that the Financial Statements would be used in connection with an offer to sell securities in TSG or that the Investor Plaintiffs would be solicited for investment capital.

III. Breach of Fiduciary Duty Claim Against Bencini (Count II)

"The business judgment rule protects directors and officers from liability when they make good faith business decisions in an informed and deliberate manner." *Munford. Inc. v. Valuation Research Corp.*,

98 F.3d 604, 611 (11th Cir. 1996). Under the business judgment rule officers are presumed to have acted properly and in good faith, and may be liable "for their actions only when they are shown to have engaged in fraud, bad faith or an abuse of discretion." Cottle v. Storer Communication, Inc., 849 F.2d 570, 574 (11th Cir. 1988).

It is undisputed that Bencini accurately recorded TSG's "core financial information" in the general ledger and provided D&D with "full, complete and accurate information concerning all aspects of the company's finances and status of various projects." Doc. 96, ¶¶ 18, 50. Plaintiffs' complaint essentially centers on the alleged erroneous accounting treatment Bencini applied to some financial data. Accounting is by its nature an inexact science and necessarily requires the exercise of business judgment.

By relying on outside accounting experts, Bencini discharged his duty to act in an informed and deliberate manner as required under the business judgment rule. *See Munford*, 98 F.3d at 611; *Cottle*, 849 F.2d at 578. The mistakes Plaintiffs allege involve decisions as to the application of relevant accounting principles. There are no allegations of self-dealing on the part of Bencini. In the event Bencini incorrectly applied accounting standards, Bencini reasonably relied upon D&D, as independent auditors, to review TSG's financial statements and confirm that the proper accounting treatment had been applied. More importantly, the record shows that (1) Bencini reported TSG's true financial condition to his superior, Walker, who was responsible for reporting to the

Board regarding the operations, activities, and financial affairs of TSG, and that (2) because Bencini was not present at the June 15 meeting, he cannot be responsible for any statements said or unsaid by Walker at that meeting.

In that the record does not contain sufficient evidence on which a reasonable jury could find that Bencini committed fraud, acted in bad faith, or abused his discretion, the business judgment rule precludes any claim for breach of fiduciary duty against Bencini. Therefore, Plaintiffs' claim for breach of fiduciary duty against Bencini fails as a matter of law.

IV. Breach of Fiduciary Duty Claim Against D&D (Count III)

Plaintiffs allege that, at all relevant times, a fiduciary relationship existed between D&D and Plaintiffs. Plaintiffs further allege that D&D breached its fiduciary duty by failing to audit TSG's Financial Statements in accordance with Generally Accepted Auditing Standards ("GAAS") and by failing to advise the TSG Board of the inappropriate financial transactions involving Walker. A claim for breach of fiduciary duty requires (1) the existence of a fiduciary duty; (2) breach of that duty; and (3) damage proximately caused by the breach. *Griffin v. Fowler*, 260 Ga. App. 443, 445, 579 S.E.2d 848, 850 (2003).

Generally, an accountant hired to audit the financial statements of a client is not a fiduciary of the client, but rather is required to be independent of the client. *See, e.g., Resolution Trust Corp. v. KPMG Peat*

Marwick, 844 F. Supp. 431, 436 (N.D. Ill. 1994) (holding independent auditor not in fiduciary relationship with client); *FDIC v. Schoenberger,* 781 F. Supp. 1155, 1157 (E.D. La. 1992)(finding accountants do not owe fiduciary duty to clients when providing services as auditors); *Franklin Supply Co. v. Tolman,* 454 F.2d 1059, 1065 (9th Cir. 1971)(holding accounting firm not in fiduciary relationship with client); *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP,* 110 Wash. App. 412, 434, 40 P.3d 1206, 1218 (2002)(holding absent special circumstances, auditor is not fiduciary of client). D&D was hired by TSG to perform an independent audit of its financial statements and file certain tax returns. As an independent auditor, D&D was not a fiduciary of, and owed no fiduciary duties to, TSG. Accordingly, TSG, as a matter of law, cannot claim a breach of fiduciary duty by D&D.

Generally, accountants owe no fiduciary duties to third parties who have no contractual or other relationship with the accountants. *See, e.g., Baldwin v. Kulch Assocs., Inc.*, 39 F. Supp. 2d 111, 121 (D.N.H. 1998)(finding no fiduciary duty from accountant to third party investors); *Venturtech II v. Deloitte Haskins & Sells*, 790 F. Supp. 576, 588 (E.D.N.C. 1992)(finding no fiduciary duty from accountant to third party investors because, although element of trust or confidence present, no element of superiority or influence); *Gutfreund v. Christoph,* 685 F. Supp. 1378 (N.D. Ill. 1987)(finding no fiduciary duty from accountant to third party without "close relationship" with accountant); *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 24, 945 P.2d 317, 335

(1996)(finding no fiduciary duty from accountant to third party buyer, because mere reliance on accountant's superior knowledge does not transform a duty of ordinary care into a fiduciary duty). The Investor Plaintiffs in this case are all third parties to the audit contract between D&D and TSG, and D&D had no relationship with them, professional or otherwise. Thus D&D owed no fiduciary duties to those plaintiffs, and the Investor Plaintiffs' claims against D&D for breach of fiduciary duty fail as a matter of law.

V. Negligence Claims (Counts I & IV)

Plaintiffs' assert claims for professional negligence and ordinary and/or gross negligence against D&D. Specifically, Plaintiffs allege D&D did not conduct its audit in accordance with GAAS and grossly and materially overstated TSG's earnings for the year ended December 31, 2000. Plaintiffs also allege that D&D failed to advise TSG of the requirement to file tax returns for the U.S. Virgin Islands and failed to alert them to inappropriate financial transactions by Walker.

A. Investor Plaintiffs

1. Professional Negligence Claim

Georgia law "provides only one cause of action to persons who are not clients of an accounting firm but who wish to sue the firm and any of its accountants for professional negligence: an action for negligent misrepresentation." *White*, 249 Ga. App. at

670. "The essential elements of negligent misrepresentation are '(1) the defendant's negligent supply of false information to foreseeable persons, known or unknown; (2) such persons' reasonable reliance upon that false information; and (3) economic injury proximately resulting from such reliance.'" *Marquis Towers. Inc. v. The Highland Group*, 593 S.E.2d 903, 906 (Ga. App. 2004)(quoting *Hardaway Co. V. Parsons, Brinckerhoff, Quade & Douglas, Inc.*, 267 Ga. 424, 426(1), 479 S.E.2d 727 (1997). To prevail, Plaintiffs must show that they are persons, or in the limited class of persons, who the professional is "actually aware" will rely upon the information prepared. *Martha H. West Trust v. Market Value of Atlanta. Inc.*, 262 Ga. App, 90, 92, 584 S.E.2d 688, 691 (2003); *Badische Corp. v. Caylor*, 257 Ga. 131, 133, 356 S.E.2d 198, 200 (1987). "[W]here the plaintiffs are third parties who are not in privity with the party alleged to have made the negligent misrepresentation, recovery may be had only when the 'known third party's reliance was the desired result of the misrepresentation.'" *Martha H. West Trust* at 92; *White*, 249 Ga. App. at 670.

The Investor Plaintiffs were not clients of D&D at any time relevant to this case. The record contains no evidence showing that D&D was actually aware that any of the Investor Plaintiffs would be making loans to TSG and that D&D knew that they would rely on the information contained in their audit when making loans to TSG.[20] Additionally, there is not

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[20]The Engagement Letter explicitly states that D&D's audits were not "planned or conducted in contemplation of

sufficient evidence to create a genuine issue of material fact regarding reasonable reliance. The reasonable reliance element is similar to the justifiable reliance element of fraud. As discussed *supra*, the Investor Plaintiffs did not justifiably rely, if they relied at all, on D&D's audit report. Accordingly, the Investor Plaintiffs' claims of professional negligence fail as a matter of law.

2. Ordinary/Gross Negligence claim

To maintain a cause of action for ordinary negligence, a plaintiff must prove the following elements: (1) a legal duty to conform to a standard of conduct; (2) a breach of this duty; (3) a causal connection between the conduct and the resulting injury; and (4) damage to the plaintiff. *Martha H. West Trust,* 262 Ga. App. at 91. In order to prevail on their claims of negligence, the Investor Plaintiffs must show a causal connection between the conduct and the resulting injury. *Martha H. West Trust*, 262 Ga. App. at 91. "Although the question of proximate cause is ordinarily for the jury to decide, plain and indisputable cases may be decided by the court as a matter of law, In such plain cases, the inquiry is whether the causal connection between the defendant's conduct and the injury is too remote for the law to countenance a recovery." *Thomas*, 256 Ga. App. at 883. The Court finds this is one of those plain and indisputable cases.

Viewing all inferences in favor of the Investor

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reliance by any third party or with respect to any specific transaction." (Defs.' Ex. 1, p. 2).

Plaintiffs, the record contains no evidence that the Financial Statements were the proximate cause of the Investor Plaintiffs' damages. There is no evidence on which a jury could reasonably find that the Investor Plaintiffs invested money in TSG because of the information contained in the Financial Statements. Even if that were the case, the Investor Plaintiffs did not lose their investment because of any errors contained in the Financial Statements, but instead because of the lack of income generated by TSG. The Investor Plaintiffs' claims for negligence fail as a matter of law.

B. TSG claims

TSG has presented sufficient evidence to create a genuine issue of material fact concerning D&D's alleged professional, ordinary, and gross negligence. *See* Expert Witness Report of Mark I. Murovitz (Doc. 52). The Court notes that the damages for which D&D may be liable are potentially limited in two ways: (1) by the terms of the contractual agreement between TSG and D&D[21] and (2) by the causation element of

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[21]The Engagement Letter contains an indemnity clause and an exculpatory clause, which states "In no event shall [D&D] be liable to [TSG], whether a claim be in tort, contract or otherwise, for any consequential, indirect, lost profit or similar damages relating to [D&D's] services provided under this engagement letter, except to the extent finally determined to have resulted from the willful misconduct or fraudulent behavior of [D & D] relating to such service."

the tort of negligence.[22] However, the Court will not make that determination at this time.

VI. Breach of Contract Claim (Count VI)

Plaintiffs allege that D&D had an obligation to audit and report TSG's financial statements in accordance with GAAS pursuant to the agreement between TSG and D&D. Plaintiffs further allege that D&D breached the terms of the agreement by failing to perform its audit under GAAS standards and by performing its services in a negligent, incompetent, and misleading manner. Plaintiffs claim to be either direct or third-party beneficiaries of the agreement.

A. Investor Plaintiffs

All Investor Plaintiffs must assert their claim for breach of contract as third party beneficiaries because they were not parties to the audit contract. "In order for a third party to have standing to enforce a contract it must clearly appear from the contract that it was intended for his benefit. The mere fact that he would benefit from performance of the agreement is not alone sufficient. Unless such an intention is shown from the face of the contract, defendant is under no duty and consequently plaintiff acquires no right as the third party beneficiary." *McClung Surveying, Inc. v. Worl,* 247 Ga. App. 322, 325-36, 541 S.E.2d 703, 707

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[22]The Court questions whether most of the damages claimed by TSG were proximately caused by the alleged negligent audit report and Financial Statements, but it will not make that determination at this time.

(2000). "A contract is intended to benefit a third party when the promisor engages to the promisee to render some performance to a third person." *Id.*

The Engagement Letter, set the terms of D&D's audit. When looking at the face of the contract, the Court finds no intent to benefit any of the Investor Plaintiffs. To the contrary, the Engagement Letter explicitly states that the audits were intended for the benefit of "the Company" and not for third parties. The Engagement Letter states that "[t]he audits will not be planned or conducted in contemplation of reliance by any third party or with respect to any specific transaction." The integration clause in the Engagement Letter states that the letter represents the entire agreement between D&D and TSG, and Plaintiffs have not alleged or presented evidence that there was a separate agreement designating the Investor Plaintiffs as third-party beneficiaries. Because the record clearly shows that the Investor Plaintiffs were not intended third-party beneficiaries, they have no standing to sue on this claim. Accordingly, the Investor Plaintiffs' breach of contract claim fails as a matter of law.

B. TSG

According to the terms of the contract between D&D and TSG, D&D was obligated to perform its audit in accordance with GAAS. The record contains sufficient evidence to create a genuine issue of material fact on TSG's claim for breach of contract against D&D. *See* Expert Witness Report of Mark I. Murovitz (Doc. 52). The Court notes, however, that the

damages claimed by TSG are potentially limited,[23] but the Court will not make that determination at this time.

VII. Negligent Retention and Supervision Claim (Count VII)

Plaintiffs allege that D&D was negligent in its retention and/or supervision of its employees or agents. In order to maintain an action for negligent retention and supervision, a plaintiff must show that the employer knew or should have known of the employee's propensity to engage in the conduct which caused the plaintiff's injury. *Herrin Bus. Prods., Inc. v. Ergle*, 254 Ga. App. 713, 717, 563 S.E.2d 442, 446 (2002); *Brooks v. H.J. Russell & Co.*, 66 F. Supp. 2d 1349, 1355 (N.D. Ga. 1999). Proof of such propensity must consist of evidence substantially related to the

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[23]The contract damages may be limited by the contract's indemnity clause, the contract's exculpatory clause, or by general contract law. "Damages growing out of a breach of contract, in order to form a basis of recovery, must be such as could be traced solely to the breach, be capable of exact computation, must have arisen according to the usual course of things, and be such as the parties contemplated as a probable result of such breach. The measure of damages in the case of a breach of contract is the amount which will compensate the injured person for the loss which a fulfillment of the contract would have prevented or the breach of it entailed. In other words, the person injured is, so far as it is possible to do so by a monetary award, to be placed in the position he would have been in had the contract been performed. An injured party can not be placed in a better position than he would have been in if the contract had not been breached." *Crawford & Assocs., Inc. v. Groves-Keen, Inc.*, 127 Ga. App. 646, 650, 194 S.E.2d 499, 502 (1972)(internal quotations and citations omitted); *see also* O.C.G.A. § 13-6-2.

injury-causing conduct. *Herrin Bus. Prods,* 254 Ga. App. at 713.

Other than the conduct alleged in the present suit, Plaintiffs have offered no evidence showing that any of D&D's employees had a propensity to engage in any fraudulent or negligent conduct. On the other hand, D&D has presented evidence showing that none of the auditors involved has ever been sued for or accused of negligence or any other professional misconduct. Plaintiffs' mere allegations of negligent retention and/or supervision are not sufficient to create a genuine issue of material fact. Thus, even if the auditors may have been negligent in conducting TSG's year 2000 audit and producing the Financial Statements, Plaintiffs have not shown how D&D knew or should have known of a propensity for this alleged conduct. Accordingly, Plaintiffs' negligent retention and supervision claim fails as a matter of law.

VIII. Punitive Damages and Attorneys' Fees Claims (Counts VIII & IX)

Plaintiffs assert that they are entitled to punitive damages because Defendants breached their fiduciary duties and because Defendants' actions showed willful misconduct, malice, fraud, wantonness, oppression, or that entire want of care which would raise the presumption of conscious indifference to consequences. In order for Plaintiffs to recover punitive damages, Defendants alleged "culpable conduct must be more than negligence, even gross negligence." *Taylor v. Powertel, Inc.,* 250 Ga. App. 356, 357, 551 S.E.2d 765, 768 (2001). As previously

discussed, the record does not contain sufficient evidence to create a genuine issue of material fact as to fraud, malice, or willful misconduct on the part of Defendants. The evidence contained in the record shows that, at most, Defendants may have been grossly negligent in conducting TSG's year 2000 audit. Thus, Plaintiffs are not entitled to punitive damages, and their claim fails as a matter of law.

Plaintiffs also argue that they are entitled to statutory attorney's fees because Defendants have acted in bad faith in its dealings with Plaintiffs and have caused Plaintiffs unnecessary trouble and expense. "'Bad faith' is not simply bad judgment or negligence, but it imports a dishonest purpose or some moral obliquity, and implies conscious doing of wrong, and means breach of known duty through some motive of interest or ill will." *Rapid Group, Inc. v. Yellow Cab of Columbus, Inc.*, 253 Ga. App, 43, 49, 557 S.E.2d 420, 426 (2001)(quoting *Vickers v. Motte,* 109 Ga. App. 615, 619-20, 137 S.E.2d 77 (1964). "[B]ad faith cannot be prompted by an honest mistake as to one's rights or duties but must result from some interested or sinister motive." *Id.* "[P]roof of mere negligence or bad judgment is not proof that [Defendants] refused to fulfill [their] professional duties, out of some interested or sinister motive, or that [they] consciously acted for some dishonest or improper purpose." *Id.* (quoting *Michaels v. Gordon,* 211 Ga. App. 470, 473, 439 S.E.2d 722 (1993). There is no competent evidence in the record that indicates Defendants acted in bad faith.

When there is no bad faith and the only other asserted basis for recovery of attorneys fees is the

causing of unnecessary trouble and expense, "there is not 'any evidence' to support an award pursuant to [O.C.G.A. § 13-6-11] if a bona fide controversy clearly exists between the parties." *Backus Cadillac-Pontiac, Inc. v. Brown*, 185 Ga. App. 746, 747, 365 S.E.2d 540, 541 (1988)(quoting *Buffalo Cab Co. v. Williams*, 126 Ga. App. 522, 525, 191 S.E.2d 317 (1972). Thus, if the evidence shows that "a genuine dispute exists – whether of law or fact, on liability or amount of damages, or on any comparable issue, then attorney fees are not authorized under O.C.G.A. § 13-6-11." *Id.* The record contains evidence showing that there is a bona fide controversy in this case, and thus, Plaintiffs are not entitled to attorneys fees based on unnecessary trouble and expense. Accordingly, Plaintiffs claim of attorneys fees fails as a matter of law.

MOTION FOR INDEMNIFICATION

Bencini moves the Court to order TSG to advance his legal fees and expenses relating to this lawsuit. The Court construes Bencini's motion for advance of legal fees and expenses as a motion for indemnification of legal fees and expenses.

Article 8, Part 5 of the Georgia Business Corporation Code addresses indemnification and advances for expenses related to litigation for officers of a corporation. See O.C.G.A. §§ 14-2-850 to -859. Code Section 14-2-857(c) grants an officer of a corporation who is not a director mandatory indemnification under Code Section 14-2-852 and allows the officer to "apply to a court under Code Section 14-2-854 for indemnification or advances for

expenses ... to the same extent to which a director may be entitled to indemnification or advances for expenses .... " It is under O.C.G.A. § 14-2-854 that Bencini seeks a court-ordered advance of expenses, or indemnification.

This Court is required to order indemnification or advances for expenses where it determines that the officer is entitled to indemnification under Part 5 of the Georgia Business Corporation Code. O.C.G.A. § 14-2-854(a)(1). Georgia law requires a corporation to indemnify an officer who was wholly successful on the merits in the defense of a proceeding to which he was a party because he was an officer of the corporation. O.C.G.A. §14-2-852. This mandatory indemnification covers the reasonable expenses incurred by the officer in connection with that proceeding. *Id.*

Bencini was named as a party in this action because he was the CFO of TSG. Because his motion for summary judgment has been granted and the claims against him have been dismissed, Bencini has been wholly successful on the merits in defense of this suit. Accordingly, the Court GRANTS Bencini's motion for indemnification, and ORDERS TSG to indemnify Bencini for the reasonable expenses and legal fees incurred by him both in defending this action and in seeking indemnification for legal fees and expenses. The Court ORDERS Bencini, no later than 14 days after the date of this Order, to file with this court an affidavit enumerating the reasonable legal fees and expenses incurred in defending this action, including any fees and expenses related to the motion for advance of legal fees. Plaintiffs will have 7 days after

the filing of Bencini's affidavit to file a response.

The Court GRANTS Bencini's motion for summary judgment and dismisses all claims against him. The Court PARTIALLY GRANTS D&D's motion for summary judgment dismissing all claims of Plaintiffs Mayer, Steward, Sprague, John Bolz, Robert Bolz, Holden, and OGM, and dismissing TSG's claims for fraud/securities fraud, breach of fiduciary duty, negligent retention and supervision, punitive damages, and attorneys' fees. TSG's claims for professional negligence, ordinary and/or gross negligence, and breach of contract are not dismissed.

The Court DENIES Plaintiffs' motion for oral argument and motion for reconsideration.

So ORDERED.

/s/
JOHN F. NANGLE
UNITED STATES DISTRICT JUDGE

Dated: 5/10/04

UNITED STATES DISTRICT COURT
Southern District of Georgia

Case Number: 4:02-cv-00258
Date Served: May 11, 2004
Served By: Karen Stephen

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___ Copy given to Magistrate

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

TSG WATER RESOURCES, INC. et al,
Plaintiffs,

v. Case No. CV 402-258

D'ALBA & DONOVAN CERTIFIED
PUBLIC ACCOUNTANTS, P.C. et al.
Defendants.

ORDER

Before the Court is plaintiffs' motion to remand (Doc. 12) and plaintiffs' motion for leave to supplement motion to remand (Doc. 39). Plaintiffs' motion to supplement (Doc. 39) is hereby GRANTED. For the following reasons, plaintiffs' motion to remand (Doc. 12) is hereby DENIED.

I. Background

Plaintiffs filed the instant action in state court alleging: (1) professional negligence; (2) breach of fiduciary duty; (4) negligence; (5) securities fraud[1]; (6) breach of contract; and (7) negligent retention and supervision. Defendants removed the case to federal court, alleging diversity jurisdiction pursuant to 28 U.S.C. § 1332. *See* Doc. 1. Plaintiffs now move to

[1]Plaintiffs allege only state securities violations. See Doc. 12 at 2.

remand on the ground that complete diversity does not exist.[2] Specifically, plaintiffs contend that plaintiff TSG Technologies, Inc. ("TSG Tech") and defendant Morris Bencini "Bencini" are both citizens of the State of Florida. Because it is undisputed that defendant Bencini is a Florida resident and citizen, the sole question before the Court is whether TSG Tech also can be considered a Florida citizen. For the following reasons, the Court determines that TSG Tech cannot be considered a Florida citizen and that complete diversity therefore exists.

II. Legal Standard

Removal of a case from state to federal court is proper if the case could have been brought originally in federal court. *See* 28 U.S.C. § 1441(a). On a motion to remand, the removing party has the burden of establishing federal jurisdiction, and any doubt should be resolved in favor of remand. *See Diaz v. Sheppard,* 85 F.3d 1502, 1505 (11th Cir. 1990); *Burns v. Windsor Ins. Co.,*31 F.3d 1092,1095 (11th Cir. 1994).

Diversity jurisdiction requires that each plaintiff be a citizen of a state different from that of any of the defendants. *Bel-Bel Int'l Corp. v. Cmty. Bank of Homestead,* 162 F.3d 1101, 1106 (11th Cir. 1998). For purposes of diversity jurisdiction, a corporation is "a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." 28 U.S.C. §

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[2]Plaintiffs do not dispute that the amount in controversy requirement has been met.

1332(c)(1)(1994). A corporation's "principal place of business" is determined by looking at the "total activities" of the corporation. *Bel-Bel*, 162 F.3d at 1106 (citing *Village Fair Shopping Ctr. v. Sam Broadhead Trust*, 588 F.2d 431, 434 (5th Cir. 1979).[3]

The "total activities" test incorporates both the "place of activities" and the "nerve center" tests. *Toms v. County Quality Meats, Inc.*, 610 F.2d 313, 315 (5th Cir. 1980). The "nerve center" test places general emphasis on the locus of the managerial and policymaking functions of the corporation. *Id.* at n. 6. The "nerve center" test is applied when a corporation has varied activities which are carried on in different states. In such situations, the nerve center, or corporate offices, will be the principal place of business at which a corporation does business; the corporation's activities are dispersed to the point that no place in which the corporation conducts operations or activities is principal. *Id.* By contrast, the "place of activities" test focuses on production or sales activities. *Id.*

III. Facts

A. Nature of TSG Tech's business

TSG Tech is in the business of designing, building and "occasionally" operating water and waste water treatment plants. TSG Tech Dep. at 10.

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[3]In *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981) (en banc), the Eleventh Circuit adopted as binding precedent all decisions of the former Fifth Circuit rendered prior to October 1, 1981.

Although TSG Tech designs and constructs its water and waste water treatment plants in Gainesville, Florida, many of the water and waste water treatment plants that TSG Tech operates are in the Caribbean. *Id.* at 12. In 2002, most of TSG Tech's revenue came from work in the Caribbean. *Id.* at 60.

B. Georgia business

TSG Tech is incorporated in Georgia and is a wholly owned subsidiary of TSG Water Resources, Inc., a Georgia corporation ("TSG Water"). TSG Tech Dep. at 15. TSG Tech has always supplied a Georgia address to the Georgia Secretary of State and lists a Savannah, Georgia address on its tax returns. *Id.* at 20-25, 34. TSG Water supplies all of TSG Tech's employees and all of its capital not generated from business operations. *Id.* at 21-22,35. TSG Tech's president and both of its directors live in Savannah. *Id.* at 9-11.

TSG Water performs accounting and payroll functions in Savannah for TSG Tech. Id. at 70-71, 77-78. TSG's primary bank account is in Savannah. *Id.* at 20, 24-25. All signatories on the primary bank account work in Savannah. *Id.* at 20. The bank statements on the primary bank account go to Savannah. *Id.* at 22. TSG Tech's clients send their checks to Savannah. *Id.* at 70.

TSG's Tech's in-house legal counsel lives in Savannah. *Id.* at 11,43-44,47. Before TSG Tech can execute any significant contracts, its in-house counsel must review them. *Id.* at 11, 46-47. TSG Tech's

corporate records, banking records, accounting records and original contracts are maintained in Savannah. *Id.* at 25. TSG Tech's financial information is reflected on the financial statements of TSG Water, which are prepared in Savannah. *Id.* at 53, 70-71. TSG Water provides insurance for TSG Tech from Savannah. *Id.* at 77-78.

C. Florida business

Most of the decisions "as to the business of TSG Technologies are made by the project managers in Florida." TSG Tech Dep. at 45. Decisions about the contents of TSG Tech's marketing materials are made in Florida. *Id.* at 58. All records relating directly to "the business that [TSG Tech] does with clients and customers" are retained in Gainesville, Florida. *Id.* at 25. On any given project, TSG Tech does all of its design and engineering, much of its purchasing and most of its fabrication in Gainesville. *Id.* at 56.

Seven of TSG Water's twenty-one employees live in Gainesville and do most of their work for TSG Tech. TSG Tech Dep. at 21-22, 27, 38. At one time or another, however, all of TSG Water's employees have performed work for TSG Tech. *Id.* at 36-37. At least three of the TSG Water employees who perform most of their work for TSG Tech live in the Caribbean. *Id.* at 39. The seven employees in Gainesville handle "virtually all" of TSG Tech's design and construction work. Sprague Aff. at ¶ 13. Dean Bedford, one of TSG Tech's Gainesville employees, is primarily responsible for the water treatment portion of TSG Tech's business and handles that portion of the business on a

day-to-day basis. TSG Tech Dep. at 47. Similarly, Kiera Fitzgerald, a Gainesville employee, is primarily responsible for TSG Tech's waste water matters. *Id.* at 86. Ms. Fitzgerald handles that portion of TSG Tech's business on a day-to-day basis. *Id.*

TSG Tech's assets in Florida include furniture, fixtures, tools, equipment, "very modest" inventory and a vehicle. *Id.* at 53, 78. TSG Technologies maintains its website out of its Gainesville office. *Id.* at 58. All e-mails generated by the website are directed to an employee in the Gainesville office. Sprague Aff. at ¶ 16. Personnel records for TSG Tech's Gainesville employees are maintained in duplicate in Gainesville and Savannah. TSG Tech Dep. at 76. All of TSG Tech's sales orders, invoices, billing records and purchasing records originate from its Gainesville office. Sprague Aff. at ¶ 14.

TSG Tech incurred no income tax liability to the State of Florida in 2002. TSG Tech Dep. at 80. TSG Tech's board of directors have never met in Florida. *Id.* at 15.

IV. Analysis

For the following reasons, the Court finds that TSG Tech's principal place of business is in Georgia, thus rendering this federal Court an appropriate forum for the resolution of the parties' legal dispute. The Court finds instructive the former Fifth Circuit's "total activities" analysis in *Toms v. Country Quality Meats, Inc.*, 610 F.2d 313 (1980). In *Toms*, a Texas corporation ("B&W") helped to create sixty

corporations across the country in the wholesale and retail meat business. The citizenship of one of these corporations, Country Quality Meats, Inc. ("Country Quality"), was at issue.

Country Quality was incorporated in Georgia and had its own staff. Major accounting functions were performed for Country Quality by B&W in Texas. Although Country Quality had a local bank account in Georgia for daily use, it drew its funds for managerial operations from a bank account in Texas. B&W performed all of Country Quality's legal work, carried insurance for Country Quality, provided at least part of Country Quality's operating capital, formulated some aspects of Country Quality's business policy, and had all sales reports, time cards and payroll sheets mailed to B&W in Texas. Tom's, 610 F.2d 313, 314-15. B&W supplied and approved Country Quality's managerial personnel. *Id.* at 316. The return address on Country Quality's income tax forms was in Texas. *Id.* at 315. Based on these facts, the Fifth Circuit found that Country Quality's principal place of business was in Texas. Specifically, the Court stated:

> While it is true that Georgia was where this corporation came into contact with the public, where the daily activities of the corporation occurred, and where its tangible assets were located, we find that the activity which occurred in Texas was more significant because Country Quality was essentially run from there.

Id. at 315.

In the case at bar, this Court finds that, while TSG Tech comes into contact with the public in Florida, many of the daily activities of TSG Tech occur in Florida, and TSG Tech maintains its tangible assets in Florida, the activity which occurs in Georgia is more significant. As discussed above, TSG Tech supplies a Georgia address to the Georgia Secretary of State and lists a Savannah address on its tax returns. The accounting and payroll functions for TSG Tech are performed in Savannah. The corporate books and records are maintained in Savannah. Financial statements are issued from Savannah. Insurance is provided from Savannah. The primary bank account and all of its signatories are located in Savannah. In-house legal counsel, who must review and approve all of TSG Tech's significant legal contracts, is in Savannah. TSG Tech's president and both of its directors are in Savannah. TSG Tech's clients send their checks to Savannah. Given all these factors, The Court finds that TSG Tech's principal place of business is in Savannah, Georgia, and that complete diversity therefore exists between the plaintiffs and defendants.

V. Conclusion

For the foregoing reasons, the Court hereby DENIES plaintiffs' motion to remand (Doc. 12).

VI. Scheduling Order

Plaintiffs shall file their expert reports THIRTY days from the date of this Order. Defendants shall file their expert reports SIXTY days from the date of this Order. Discovery shall end SEVENTY-FIVE days from

the date of this Order. All motions, other than motions in limine, shall be filed no later than ONE HUNDRED AND FIVE days from the date of this Order.

/s/
JOHN F. NANGLE
UNITED STATES DISTRICT JUDGE

Dated: 3-7-03

UNITED STATES DISTRICT COURT
Southern District of Georgia

Case Number: 4:02-cv-00258
Date Served: March 7, 2003
Served By: Betsy C. West

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UNITED STATES DISTRICT COURT
Southern District of Georgia

Case Number: 4:02-cv-00258
Date Served: March 10, 2003
Served By:

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§ 1332. Diversity of citizenship; amount in controversy; costs

(a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $ 75,000, exclusive of interest and costs, and is between–

(1) Citizens of different States;

(2) citizens of a State and citizens or subjects of a foreign state;

(3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and

(4) a foreign state, defined in section 1603(a) of this title [28 USCS § 1603(a)], as plaintiff and citizens of a State or of different States.

For the purposes of this section, section 1335 [28 USCS § 1335], and section 1441 [28 USCS § 1441], an alien admitted to the United States for permanent residence shall be deemed a citizen of the State in which such alien is domiciled.

(b) Except when express provision therefor is otherwise made in a statute of the United States, where the plaintiff who files the case originally in the Federal courts is finally adjudged to be entitled to recover less than the sum or value of $ 75,000, computed without regard to any setoff or counterclaim to which the defendant may be adjudged to be entitled,

and exclusive of interest and costs, the district court may deny costs to the plaintiff and, in addition, may impose costs on the plaintiff.

(c) For the purposes of this section and section 1441 of this title [28 USCS § 1441]--

(1) a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business, except that in any direct action against the insurer of a policy or contract of liability insurance, whether incorporated or unincorporated, to which action the insured is not joined as a party-defendant, such insurer shall be deemed a citizen of the State of which the insured is a citizen, as well as of any State by which the insurer has been incorporated and of the State where it has its principal place of business; and

(2) the legal representative of the estate of a decedent shall be deemed to be a citizen only of the same State as the decedent, and the legal representative of an infant or incompetent shall be deemed to be a citizen only of the same State as the infant or incompetent.

(d) (1) In this subsection–

(A) the term "class" means all of the class members in a class action;

(B) the term "class action" means any civil action filed under rule 23 of the Federal Rules of Civil Procedure or similar State statute or rule

of judicial procedure authorizing an action to be brought by 1 or more representative persons as a class action;

(C) the term "class certification order" means an order issued by a court approving the treatment of some or all aspects of a civil action as a class action; and

(D) the term "class members" means the persons (named or unnamed) who fall within the definition of the proposed or certified class in a class action.

(2) The district courts shall have original jurisdiction of any civil action in which the matter in controversy exceeds the sum or value of $ 5,000,000, exclusive of interest and costs, and is a class action in which–

(A) any member of a class of plaintiffs is a citizen of a State different from any defendant;

(B) any member of a class of plaintiffs is a foreign state or a citizen or subject of a foreign state and any defendant is a citizen of a State; or

(C) any member of a class of plaintiffs is a citizen of a State and any defendant is a foreign state or a citizen or subject of a foreign state.

(3) A district court may, in the interests of

justice and looking at the totality of the circumstances, decline to exercise jurisdiction under paragraph (2) over a class action in which greater than one-third but less than two-thirds of the members of all proposed plaintiff classes in the aggregate and the primary defendants are citizens of the State in which the action was originally filed based on consideration of–

(A) whether the claims asserted involve matters of national or interstate interest;

(B) whether the claims asserted will be governed by laws of the State in which the action was originally filed or by the laws of other States;

(C) whether the class action has been pleaded in a manner that seeks to avoid Federal jurisdiction;

(D) whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm, or the defendants;

(E) whether the number of citizens of the State in which the action was originally filed in all proposed plaintiff classes in the aggregate is substantially larger than the number of citizens from any other State, and the citizenship of the other members of the proposed class is dispersed among a substantial number of States; and

(F) whether, during the 3-year period preceding

the filing of that class action, 1 or more other class actions asserting the same or similar claims on behalf of the same or other persons have been filed.

(4) A district court shall decline to exercise jurisdiction under paragraph (2)--

(A) (i) over a class action in which–

(I) greater than two-thirds of the members of all proposed plaintiff classes in the aggregate are citizens of the State in which the action was originally filed;

(II) at least 1 defendant is a defendant–

(aa) from whom significant relief is sought by members of the plaintiff class;

(bb) whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiff class; and

(cc) who is a citizen of the State in which the action was originally filed; and

(III) principal injuries resulting from the alleged conduct or any

related conduct of each defendant were incurred in the State in which the action was originally filed; and

(ii) during the 3-year period preceding the filing of that class action, no other class action has been filed asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons; or

(B) two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed.

(5) Paragraphs (2) through (4) shall not apply to any class action in which–

(A) the primary defendants are States, State officials, or other governmental entities against whom the district court may be foreclosed from ordering relief; or

(B) the number of members of all proposed plaintiff classes in the aggregate is less than 100.

(6) In any class action, the claims of the individual class members shall be aggregated to determine whether the matter in controversy exceeds the sum or value of $ 5,000,000, exclusive of interest and costs.

(7) Citizenship of the members of the proposed plaintiff classes shall be determined for purposes of paragraphs (2) through (6) as of the date of filing of the complaint or amended complaint, or, if the case stated by the initial pleading is not subject to Federal jurisdiction, as of the date of service by plaintiffs of an amended pleading, motion, or other paper, indicating the existence of Federal jurisdiction.

(8) This subsection shall apply to any class action before or after the entry of a class certification order by the court with respect to that action.

(9) Paragraph (2) shall not apply to any class action that solely involves a claim–

(A) concerning a covered security as defined under 16(f)(3) of the Securities Act of 1933 (15 U.S.C. 78p(f)(3)) and section 28(f)(5)(E) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(f)(5)(E));

(B) that relates to the internal affairs or governance of a corporation or other form of business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized; or

(C) that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security (as defined under section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1)) and the

regulations issued thereunder).

(10) For purposes of this subsection and section 1453 [28 USCS § 1453], an unincorporated association shall be deemed to be a citizen of the State where it has its principal place of business and the State under whose laws it is organized.

(11)(A) For purposes of this subsection and section 1453 [28 USCS § 1453], a mass action shall be deemed to be a class action removable under paragraphs (2) through (10) if it otherwise meets the provisions of those paragraphs.

(B) (i) As used in subparagraph (A), the term "mass action" means any civil action (except a civil action within the scope of section 1711(2) [28 USCS § 1711(2)]) in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact, except that jurisdiction shall exist only over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount requirements under subsection (a).

(ii) As used in subparagraph (A), the term "mass action" shall not include any civil action in which–

(I) all of the claims in the

action arise from an event or occurrence in the State in which the action was filed, and that allegedly resulted in injuries in that State or in States contiguous to that State;

(II) the claims are joined upon motion of a defendant;

(III) all of the claims in the action are asserted on behalf of the general public (and not on behalf of individual claimants or members of a purported class) pursuant to a State statute specifically authorizing such action; or

(IV) the claims have been consolidated or coordinated solely for pretrial proceedings.

(C) (i) Any action(s) removed to Federal court pursuant to this subsection shall not thereafter be transferred to any other court pursuant to section 1407 [28 USCS § 1407], or the rules promulgated thereunder, unless a majority of the plaintiffs in the action request transfer pursuant to section 1407 [28 USCS §

1407].

(ii) This subparagraph will not apply–

(I) to cases certified pursuant to rule 23 of the Federal Rules of Civil Procedure; or

(II) if plaintiffs propose that the action proceed as a class action pursuant to rule 23 of the Federal Rules of Civil Procedure.

(D) The limitations periods on any claims asserted in a mass action that is removed to Federal court pursuant to this subsection shall be deemed tolled during the period that the action is pending in Federal court.

(e) The word "States", as used in this section, includes the Territories, the District of Columbia, and the Commonwealth of Puerto Rico.